IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 76-1699

LEADERSHIP HOUSING, INC., and LEADERSHIP COMMUNITIES, INC.,
Appellants,

v.

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA,
Appellee.

On Appeal From the Supreme Court of the State of Florida

JURISDICTIONAL STATEMENT

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This is an appeal brought by Leadership Housing, Inc. and Leadership Communities, Inc. from the decision of the Supreme Court of Florida declaring constitutional certain Florida statutes which impose state income taxes on that portion of gain from the sale of property which accrued, as unrealized appreciation in the value of such property, during a period of time, prior to the effective date of the taxing act, when the Florida Constitution expressly prohibited the taxation of income.

The Appellants are sometimes collectively referred to herein as "Leadership". The Appellee is referred to as the "Department of Revenue".

This Jurisdictional Statement is submitted to show that this Court has jurisdiction of this appeal, and that a substantial Federal question is presented.

OPINIONS BELOW

The opinion of the Supreme Court of Florida is reported at 343 So.2d 611 (Fla. 1977) and is set forth in Appendix "A". The Amended Final Judgment of the Circuit Court, not officially reported, is set forth in Appendix "B".

JURISDICTION

Jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1257(2).

The action was commenced in the Circuit Court of the Seventeenth Judicial Circuit in and for Broward County, Florida, as a suit for Declaratory Judgment pursuant to Florida Statutes, Sections 86.011 and 86.021. Upon granting Leadership's Motion for Summary Judgment, the Circuit Court entered its Amended Final Judgment on April 23, 1975, declaring "The Florida Income Tax Code, including without limitation, [Florida Statutes] Sections 220.11, 220.12, 220.13 and 220.02(4) thereof . . ." invalid and void ab initio. App. "B", pp. 22a, 23a.

The Department of Revenue of the State of Florida appealed from the Amended Final Judgment of the Circuit Court to the Supreme Court of Florida. On March 3, 1977, the Supreme Court of Florida entered its decision here appealed from, reversing the Circuit Court and declaring the taxing statutes in ques-

tion constitutional. Leadership filed no rehearing petition in the Supreme Court of Florida, and the time for doing so expired on March 18, 1977, pursuant to Rule 3.14(a), Florida Appellate Rules, 1962 Revision. After that date, and the issuance by the Supreme Court of its mandate on March 28, 1977, the decision here appealed from became final, as of its original date of entry on March 3, 1977. See Rule 3.15, Florida Appellate Rules, 1962 Revision. Leadership timely filed a Notice of Appeal in the Supreme Court of Florida on May 27, 1977, which is set forth in Appendix "C", and in the Circuit Court of the Seventeenth Judicial Circuit in and for Broward County, Florida on May 31, 1977, which is set forth in Appendix "E".

STATUTES INVOLVED

This appeal challenges the validity of Chapter 220 of the Florida Statutes, commonly referred to as the Florida Income Tax Code, including, without limitation, Sections 220.11, 220.12, 220.13 and 220.02(4) thereof, to the extent that those statutes impose a state income tax upon that portion of gain from the sale of property which reflects appreciation in the value of such property which accrued, or arose, prior to November 2, 1971. The pertinent text of those statutes is set forth in Appendix "D."

QUESTION PRESENTED

Whether the State of Florida, by corporate income tax statutes taking effect on January 1, 1972, may tax, as gain from the sale of property after January 1, 1972, such portion of that gain as arose, in the form of unrealized appreciation, between 1924 and November 2, 1971, during which period the Constitution of the State of Florida expressly prohibited the taxation of income.

STATEMENT OF THE CASE

Statement of the Facts

(1) The Florida Constitutional Income Tax Prohibition.

On November 4, 1924, the people of Florida voted, by an overwhelming majority, to adopt a provision in the state constitution prohibiting the Florida Legislature from levying any "... tax ... upon the income of residents or citizens of this state." Fla. Const. of 1885, Art. IX, Sec. 11. This restriction on the otherwise inherent taxing power of the Florida Legislature is hereinafter called the "Constitutional Prohibition." The Florida Supreme Court has taken judicial notice that the deliberate purpose and intent underlying this constitutional measure was to attract wealthy capitalists to take up residence, and establish businesses in Florida, thereby assuring the capital formation needed for the orderly development of the state's economy. The Constitutional Prohibition was construed by the Supreme Court of Florida as intended to benefit corporate, as well as individual, residents of the state. *In re Advisory Opinion to Governor*, 243 So.2d 573 (Fla. 1971).

In substance and in legal effect, the Constitutional Prohibition against income taxation continued unchanged until November 2, 1971, when it was amended, by state referendum, so as to permit the taxation of corporate incomes, at rates not to exceed 5%. It is undisputed that the amendment of November 2, 1971 was intended to have a prospective effect only. Section 5(c), Article VII, Constitution of the State of Florida.

Several decisions of the Supreme Court of Florida between 1924 and 1971 reveal that the Florida Court

gave the Constitutional Prohibition an extremely broad and liberal construction during the years it was in full force, in order to further its intended purpose of assuring individuals and corporations that their incomes would not be taxed by Florida once they had established Florida as the state of their legal residence. *See*, for example, *Owens* v. *Fosdick*, 13 So.2d 700 (Fla. 1943), where the Florida Supreme Court disapproved the imposition of intangible personal property taxes upon a beneficial trust interest in income only. Giving the broadest conceivable construction to the Constitutional Prohibition, the Florida Court said:

> "The people of the State of Florida have declared that there shall be no tax on income levied by the state, or under its authority. Const. Fla. Art. IX, Sec. 11. This section is a definite positive proscription against such taxation by the Legislature. . . . If in its practical application, therefore, a tax falls upon that which is prohibited by this section of the Constitution of the State it cannot be upheld, no matter in what terminology the taxing statute is couched, or what the legislature has declared the tax to be. To be guided by any other view is to concede that what may not be done directly because of constitutional restrictions, may be done indirectly by legislative means accomplishing the same result, the Constitution notwithstanding. [cit.om.] Constitutional prohibitions may not thus be so lightly evaded or circumvented. Their mandates are imperative, and they must be so construed as to give full force and effect to their manifest purpose. [cit.om.]"
>
> "Construed in such manner, with appropriate emphasis being placed upon that which we think the people of Florida sought to accomplish when

> they wrote the income exemption clause into our Constitution in 1924, it is clear to us that the tax in question, in its application to the facts of the present case, was illegally imposed and is violative of Section 11 of Article IX of the Constitution of Florida." 13 So.2d at 703.

See also, in accord, *Mahan* v. *Lummus*, 35 So.2d 725 (Fla. 1948). In *State ex rel McKay* v. *Keller*, 191 So. 542 (Fla. 1939), the Florida Court again construed the Constitutional Prohibition, this time striking down a municipal license tax, with levies increasing in proportion to receipts. In its opinion, the Florida Court had occasion to consider the meaning of the term "income", as used in the Constitutional Prohibition. It clearly showed its independence of any Federal tax conceptions of the term, turning instead, to the completely open-ended definition appearing in Corpus Juris.[1]

The foregoing decisions leave no doubt as to how the Florida Supreme Court would have ruled, had the Legislature of Florida taken the unlikely step of imposing an *income tax* upon *unrealized appreciation in the value of property.* Though there is no general constitutional objection to such a tax by the states (the doctrine of *Eisner* v. *Macomber* not being binding upon the states) the Florida Supreme Court clearly would have stricken such a tax as being in violation of the Constitutional Prohibition.

Thus, by reason of the wording of the Constitutional Prohibition, as interpreted prior to November 2, 1971 by Florida's highest court, individuals

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[1] It should be noted that this Court's decision is *Eisner* v. *Macomber*, 252 U.S. 189 (1920), which the Florida Supreme Court adopted in the present case as a definition of "income", had been on the books for nineteen years at the time of the *McKay* decision.

and corporations, including Leadership, were induced to invest their capital in Florida in the reasonable belief that the incremental growth of that investment, as well as the fruits thereof, would not be taxed as income. Moreover, those corporations, such as Leadership, faced with a clearly prospective amendment of the Constitutional Prohibition of November 2, 1971, reasonably believed that unrealized appreciation which arose or accrued *prior* to that date would continue to be accorded the immunity guaranteed under the prior income tax prohibition.

However, following the adoption of the prospective constitutional amendment on November 2, 1971, which permitted the Florida Legislature to enact an income tax on corporate incomes, at a rate not to exceed 5%, the Florida Legislature promptly enacted a corporate income tax, effective on January 1, 1972, and adopted the Federal income tax statutes for the definition of "taxable income". Florida Statutes, Sections 220.11(1), 220.12(1), 220.13(1), (2), App. "D", pp. 29a, 31a, 36a. This meant, in the context of taxing gain from the sale of property, that the taxable income from a sale would be calculated by subtracting the historical cost of the property (adjusted as provided in the Internal Revenue Code) from the sales price. It is undisputed that the Florida act, by omitting a "step-up in basis" provision (similar, in effect, to Internal Revenue Code [26 U.S.C.] section 1053) to eliminate taxation of values which arose during the period of the income tax prohibition, therefore taxes such appreciation, as income, at the time of a sale of the property.

In the present case, the Supreme Court of Florida adopted, as the definition of "income" intended in the 1924 Constitutional Prohibition, this Court's now abandoned decision in the 1920 case of *Eisner* v.

Macomber, 252 U.S. 189 (1920). *See, Miriam Sakol,* Docket No. 4834-74, 67 T.C. —, No. 81, March 23, 1977. Then, following this new and restrictive interpretation of the Constitutional Prohibition, which is patently inconsistent with its decisions contemporaneous with the Constitutional Prohibition itself, the Florida Supreme Court concluded, in the decision here appealed from, that since "income" does not arise until the point of its "realization" through a sale, and since the statutes here in question seek only to tax those sales concluded on or after January 1, 1972, the fact that such "income" reflects value gains which occurred during the period of the Constitutional Prohibition is of no legal significance. Having so decided, the Florida Court summarily rejected Leadership's due process claims, without discussing any of the authorities urged in their support, and without any attempt to reconcile its adoption of *Eisner* v. *Macomber* with its earlier interpretation of the Constitutional Prohibition.

(2) The Appellants.

Leadership Housing, Inc. is a Delaware corporation, and Leadership Communities, Inc. is a Florida corporation. Both maintain their principal business offices in Broward County, Florida. Both are engaged in the business of purchasing, developing and selling land to their customers. Both acquired various tracts of land in Florida between 1924 and November 2, 1971, the date on which the Florida Constitution was amended so as partially to remove the theretofore existing prohibition on the taxation of income. Such land appreciated in value substantially between the date or dates on which it was acquired, and November 2, 1971. Portions of the land were sold in 1972 and 1973, by both corporations, occasioning tax liability under the

Florida Income Tax Code for the taxable gain realized from such sales.

Leadership asserted, before the Department of Revenue, that appreciation which occurred in its property during the period of Constitutional Prohibition, that is, prior to November 2, 1971, may not constitutionally be subject to income taxation as gain, notwithstanding clear language in Chapter 220, Florida Statutes, to the contrary. The Department of Revenue took the position that all gain, including the portion thereof which accrued as unrealized appreciation in value prior to November 2, 1971, should be included in net income subject to Florida income taxation.

How the Federal Questions were Raised and Decided Below.

Leadership then proceeded, pursuant to Chapter 86, Florida Statutes, to institute a suit for declaratory judgment in the Circuit Court of Broward County, Florida, alleging that it had income tax liability to Florida by reason of sales of land in 1972 and 1973; that it was in doubt as to the amount thereof; and seeking a declaration of the invalidity of Chapter 220, Florida Statutes, to the extent imposing income taxation on that portion of gain from the sale of property which reflected appreciation in the value of said property which accrued prior to November 2, 1971. In its complaint, Leadership claimed that the taxing statutes operated, on their face, to take property without due process of law, in contravention of the state and Federal Constitutions.

Subsequently, Leadership and the Department of Revenue filed cross-motions for summary judgment, the Circuit Court granting Leadership's motion. In its

Amended Final Judgement (App. "B", pp. 22a, 23a) the Circuit Court declared:

> "The Florida Income Tax Code, including, without limitation, [Florida Statutes] Sections 220.11, 220.12, 220.13 and 220.02(4) thereof, to the extent it imposes an income tax upon that portion of gain resulting from the sale of property which represents appreciation in the value of such property occurring prior to November 2, 1971, violates Amendment XIV, Section 1 of the Constitution of the United States of America, and Article I, Section 9 of the Constitution of the State of Florida, and is therefore invalid and void ab initio."

Though the Circuit Court rested its decision solely upon the due process clauses of the Federal and Florida Constitutions, Leadership, in its brief to the Supreme Court of Florida, set forth a separate and additional state constitutional ground to sustain the Circuit Court's Amended Final Judgment. It was, and is, Leadership's position, that while such additional state ground would have supported an affirmance of the Circuit Court's Amended Final Judgment, it was not sufficiently broad as a ground for reversal, and that the merits of the due process claim would have to be considered independently.

In its majority opinion, the Supreme Court of Florida discussed the state constitutional ground first. It disposed of Leadership's argument that the State of Florida, but for the Constitutional Prohibition, had the power to tax, as income, capital appreciation *as it arose.*

It defeated this argument, not by rejecting it as incorrect, but by adopting, for the first time, as a state

constitutional criterion for defining "income", as the term was intended in the Constitutional Prohibition, the "realization" doctrine announced by this Court (and subsequently abandoned by it) in *Eisner* v. *Macomber, supra. See Sakol, supra.* In doing so, the Florida Court interpreted the Constitutional Prohibition as not intending to immunize, from income taxation, unrealized appreciation, *as it arose.* Such decision, which itself has a retroactive effect, and is inconsistent with the Florida Court's previous decisions interpreting the Constitutional Prohibition, is an integral part of the unfair denial to Florida taxpayers of rights which they quite reasonably believed were afforded them in Florida's Constitution, and in reliance whereof they acted.

The Supreme Court of Florida clearly passed upon the Federal due process argument advanced by Leadership as Point II. The majority opinion stated:

> "The second point asserted by the Appellees is their contention that the tax is harsh, and arbitrary. Holding as we do that there is no income until realization, this argument is without merit." 343 So.2d at 615, App. "A", p. 7a.

That the Supreme Court of Florida passed upon Leadership's Federal due process claim is further apparent in the dissenting opinion, written by Justice Roberts, and concurred in by Justice Adkins, reflecting substantial reliance upon the Federal due process argument as a basis for their views. *See,* Opinion 343 So.2d at 616 and 620, App. "A", pp. 11a, 18a.

THE QUESTIONS ARE SUBSTANTIAL

The facts of this case reflect a sequence of events which viewed together, suggest the possibility of a fundamental breach of faith by a state in its dealings with a vast number of the individual and corporate citizens of this country. No less was said by the two Justices who, in a dissent from the decision here on appeal, state:

> "To break faith with those corporations . . . who invested their capital in this state in reliance upon that constitutional covenant would unquestionably be morally wrong and, in our opinion, legally impermissible as violative of the manifest purpose and intent of the 1924 income tax prohibition and the constitutional rights therein guaranteed." 343 So.2d at 618, App. "A", p. 14a.

In 1924, the people of Florida advertised to the world, by means of the state's highest order of compact, that their state legislature thereafter would be prohibited from taxing the income of those individuals and corporations who would establish residence there. In Florida, it is within judicial knowledge that the purpose of the 1924 Constitutional Prohibition was to create a favorable tax climate which would induce the investment of large sums of capital in this state. *See,* Opinion, 343 So.2d at 618, App. "A", p. 14a. The Supreme Court of Florida, itself, by contemporaneous decisions construing the Constitutional Prohibition so as to give it the broadest conceivable scope, enhanced the credibility of the Prohibition, and made more effective its appeal to non-Floridians attracted by the idea of moving to a tax-haven state.

The 1924 Constitutional Prohibition was carried forward in Florida's Constitutions for 47 years there-

after, during which period the state's population and economy expanded in geometric progression. On November 2, 1971, the Florida Constitution was amended to provide that corporations would no longer share in the constitutional shelter from income taxation. Less than one month after the 1971 constitutional amendment was adopted, the Florida Legislature placed into effect a tax on corporate incomes, including gains realized from the incremental growth on Florida investments. But the taxing act did not reach only that incremental growth which occurred *after* the Constitutional Prohibition was amended from the state Constitution; it also reached back to include, for taxation, such incremental growth as had occurred during the period of the income tax prohibition itself. Leadership, which had invested substantial capital in Florida during the period of the Constitutional Prohibition, complained in the present case to the Florida courts of the unfairness and substantial injustice which inhered in the retroactive divestiture of its constitutionally granted right to be free from state income taxation with respect to appreciation in the value of its property which occurred while the Constitutional Prohibition was in effect.

The response of a majority of the Supreme Court of Florida, as seen in the judgment here on appeal, was to construe the Constitutional Prohibition, *six years after it had been amended out of the Florida Constitution,* so that, in effect, it now reads differently than corporations had been induced to read it during the period of the Constitutional Prohibition itself, by contemporaneous constructions by the Florida Supreme Court.

There are unusual elements in this case, which Leadership submits call for the statutes here in question to be tested by Federal standards of due process. Here, there is seen the deliberate utilization of a state Constitution as a vehicle for communicating, to persons outside of that state, incentives for establishing residence there. There can be no question that Florida's Constitution had an unusual and extra-territorial reach and influence; nor can it be doubted that substantial numbers of persons outside of the state were induced to change their positions in reliance on the rights which were offered to them as a consequence of establishing residence in Florida. The opinion of the majority clearly reveals great difficulty on the part of the Florida Supreme Court in appreciating this aspect of the present controversy. Had it been otherwise, Leadership submits that the Florida Supreme Court would not have found it possible to reject summarily, without one word of explanation in its opinion, the claims of unfairness and injustice which permeated the presentation by Leadership of its due process arguments.

The questions presented in this appeal has never been decided by any state or federal court, at any time in the history of American jurisprudence. Even the constitutional parallel which existed at the Federal level, when, after *Pollock* v. *Farmers Loan & Trust Co.,* 157 U.S. 429 (1895), the 16th Amendment was ratified on February 25, 1913, produced no decision on this point. However, contemporaneous decisions by this Court strongly imply that it harbored serious doubts that Congress could constitutionally tax, as gain from the sale of property, unrealized appreciation which arose prior to the ratification of the 16th

Amendment. *See, Brushaber* v. *Union P. R. Co.*, 240 U.S. 1 (1916); *Southern Pacific Co.* v. *Lowe*, 247 U.S. 330 (1918); *Lynch* v. *Turrish*, 247 U.S. 221 (1918); *Lucas* v. *Alexander*, 279 U.S. 573 (1929); *MacLaughlin* v. *Alliance Ins. Co. of Philadelphia*, 286 U.S. 244 (1932). The absence of a direct precedent on this question results from the fact that Congress, whether out of concern for its constitutional limitations or a sense of fair play, never attempted to tax, as gain realized from the sale of property, appreciation which accrued prior to the ratification of the 16th Amendment. See Internal Revenue Code (26 U.S.C.) § 1053, and prior enactments.

MacLaughlin v. *Alliance Ins. Co., supra,* as well as six state income tax cases decided by the highest courts of six separate states, stand as precedent for the principle that a state, or Congress, may tax, as gain realized from the sale of property, appreciation in the value of that property which accrued prior to the effective date of the taxing statute without violating the due process clauses of the 14th or 5th (in the case of the Federal Congress) Amendments. *See, Fidelity & Columbia Trust Co.* v. *Reeves*, 287 Ky. 522, 154 S.W.2d 337 (1941); *Fullerton Oil Co.* v. *Johnson*, 2 Cal.2d 162, 39 P.2d 796 (1934); *Kellems* v. *Brown*, 163 Conn. 478, 313 A.2d 53 (1972); *Norman* v. *Bradley*, 173 Ga. 482, 162 S.E. 413 (1931); *Shangri-La, Inc.* v. *State*, 309 A.2d 285 (N.H. 1973); *Tiedemann* v. *Johnson*, 316 A.2d 359 (Me. 1974), but see *State ex rel. Bundy* v. *Nygaard*, 163 Wisc. 307, 158 N.W. 87 (1916).

In the *MacLaughlin* case, *supra,* as well as in each of the seven state cases cited above, there was no constitutional prohibition on income taxation in effect

during the accrual of the appreciation later sought to be taxed as gain. Thus, none of those eight cases stands as precedent for the question presented in this appeal. In fact, as has been noted, *MacLaughlin* reflects this Court's doubt as to whether Congress constitutionally could cause the federal income tax to reach backward into a prior period of constitutional disability.

The Illinois Supreme Court decision in *Thorpe* v. *Mahin*, 43 Ill. 2d 36, 250 N.E. 2d 633 (1969), reflects a situation closely parallel to the circumstances presented here. In that case, the Illinois Court, overruling a 1932 decision in which it had declared a state income tax law invalid, as against the state Constitution's uniformity clause, and upholding a 1969 taxing act, refused to permit the new act to tax appreciation which accrued prior to its effective date in 1969, when everyone supposed, by reason of the Illinois court's 1932 decision, that state income taxation was unconstitutional.

THE LEVY OF AN INCOME TAX BY THE STATE OF FLORIDA IN RESPECT OF APPRECIATION IN THE VALUE OF PROPERTY WHICH ACCRUED PRIOR TO NOVEMBER 2, 1971, AS GAIN REALIZED AFTER THAT DATE, CONSTITUTES HARSH, ARBITRARY AND OPPRESSIVE TAXATION IN VIOLATION OF THE DUE PROCESS CLAUSE OF THE CONSTITUTION OF THE UNITED STATES.

This Court has strongly implied that no tax may be upheld unless the taxpayers were reasonably forewarned of the nature of the tax. If this principle has application to income taxation, a premise which this Court's opinion in *MacLaughlin* seems to confirm, then the taxation of accumulated appreciation, as gain when later realized, is an invalid tax unless the tax-

payers reasonably could have anticipated the tax as the appreciation was accruing. Capital appreciation may not be subjected to income taxation as realized gain where taxpayers were justified in believing, as the appreciation accrued, that it would forever be excluded from taxation. Leadership justifiably relied on the Constitutional Prohibition, and was thereby led to the reasonable belief that the then occurring appreciation in the value of its property would never be subjected to tax as income.

Although the "forewarning test" was first used by this Court in cases involving Federal gift taxes, it has also been applied by this and other courts to taxation of gain as income. In a gift tax case this Court reasoned that:

> ". . . the taxpayer may justly demand to know how and when he becomes liable for taxes—he cannot *foresee* and ought not to be required to guess the outcome of pending measures". (Emph. Suppl.) *Untermyer* v. *Anderson, 276 U.S. 440 at 445 (1928).*

A few years later, this Court established an objective standard in applying its "foreseeability" test. In *Milliken* v. *U.S.,* 283 U.S. 15 at 23 (1931), the Court, recognizing that a tax which cannot be foreseen is arbitrary, suggested that a taxpayer should be

> ". . . regarded as taking his chances of any increase in the tax burden which might result from carrying out the *established policy of taxation.* . . ." (Emph.Suppl.)

Thus, once an *established policy of taxation* has been set forth by the Legislature, taxpayers are thereby forewarned that existing circumstances may later be

subjected to tax. See Frederick A. Ballard, "Retroactive Federal Taxation", 48 Harv.L.Rev. 592 at 602 (1935).

This Court impliedly used the established policy of taxation test in determining whether the taxpayer was forewarned that capital appreciation may later be taxed as income in *MacLaughlin* v. *Alliance Ins. Co. of Philadelphia,* 286 U.S. 244 (1932). There, the Court held that if, during the period in which the appreciation occurred, Congress had the constitutional power to tax the gain, and had "established a policy of taxing it", the Constitution was not violated. 286 U.S. at 250. The Court cited *Milliken* and applied its "established policy of taxation" standard, to test whether capital appreciation which occurred prior to the enactment of a taxing act could be taxed as income at the time of a sale.

Critical to this case is the Court's comment that the failure of Congress to tax the gain in the years during which the property had appreciated in value, *assuming Congress had the power to tax it,* did not preclude it from taxing the entire appreciation as gain when realized. The Court reasoned that since Congress had the *power to tax the gain during the entire period in which the appreciation occurred,* and had already established a policy of taxing gain to some classes of taxpayers, the taxpayer was constructively forewarned that such appreciation may later be taxed as gain.

The adoption of the 16th Amendment to the United States Constitution in late February of 1913 removed a constitutional impairment to the authority of Congress to tax income, including gain. Since 1916,

Section 1053 of the Internal Revenue Code, and its predecessors have provided that appreciation which occurred prior to March 1, 1913, may not be later subjected to tax as income when the gain is realized. At least one state Supreme Court commented that ratification of the 16th Amendment was "... sufficient notice to uphold Congress in fixing arbitrarily, March 1, 1913, as the pivotal date. . .". *Fidelity & Columbia Trust Co.* v. *Reeves,* 287 Ky. 522, 154 S.W.2d 337 at 343 (1941).

An application of the forewarning doctrine to the taxation by a state of gain appears in *City National Bank of Clinton* v. *Iowa State Tax Comm.,* 102 N.W.2d 381 (Iowa 1960). The Iowa Supreme Court observed that due process was violated when the nature and amount of the tax could not reasonably have been anticipated by the taxpayer. In fact, the Iowa Court said:

> "If the taxpayer is reasonably forewarned that such a gain may lated be taxed, the imposed gain would usually not be found unjustly oppressive or void." 102 N.W. 2d at 388.

To determine whether the taxpayer has been reasonably forewarned, the Iowa Court inquired:

> "... whether ... (the taxpayers) could reasonably and justly rely and depend upon the *exclusion provision* in the original income tax act ... Where they substantially and wrongfully mislead in their belief that under the circumstances existing, accrued capital increases would thereafter be used as the cost basis of such assets rather than the actual cost or reasonable market value ... in computing taxable income?" 102 N.W.2d at 388.

The Iowa Court was unable to answer the questions in the affirmative and held that the taxpayer was ***not mislead since***:

> "... the exclusion was little more than an exemption, and the public should have been aware that such exemption could be removed at any session subsequent to the enactment of the income tax law." 102 N.W.2d at 388.

In contrast to ***City National Bank*** and ***MacLaughlin,*** where the taxpayers depended upon a statutory exclusion from taxation, in the present case, Leadership relied instead upon a Constitutional Prohibition. As a result, it was led into reasonably believing that the then occurring capital appreciation could never be subjected to income taxation as gain.

Appropriate to this point is a comment of the Wisconsin Supreme Court in *Appeal of Van Dyke,* 259 N.W. 700 at 709 (Wisc. 1935):

> Of course, a law must not be given retroactive effect or application beyond the time when a constitutional amendment authorizing the enactment of a particular law becomes effective."

Gain from the sale of property is a quantification of the appreciation which has accrued since its acquisition by the sellers. In the present case, Leadership could not reasonably have believed that appreciation which occurred while the taxation of income was prohibited by the Florida Constitution would later be taxed as income.

During the period the appreciation occurred, the Florida Legislature did not have the power to tax it; there could have been no established policy of taxation.

See *MacLaughlin* and *Milliken, supra.* The right to enjoy such appreciation free from taxation, current or future, having attached, it could not later be removed, without a clear denial of due process.

As previously mentioned, although similar issues have been decided in income tax cases involving states other than Florida, each is distinguishable upon a single point. Only the State of Florida had incorporated a provision in its Constitution prohibiting the taxation of income. (However, see *Thorpe* v. *Mahin, supra.*) Only in Florida did a right protecting capital appreciation in the value of property from subsequent income taxation arise as a constitutional right. In states other than Florida, the Legislatures had the *power to tax gain as income,* and the citizens were accordingly forewarned that appreciation might later be taxed. The privilege created in those other states did not merit the protection of the Federal due process clause. The rights created in Florida, and applicable here, do warrant Federal due process protection.

THE DECISION APPEALED FROM RESTS UPON INADEQUATE STATE GROUNDS

The decision of the Florida Supreme Court purports to rest on state constitutional grounds. However, there being a Federal question properly raised and preserved in this case, this Court will inquire into the state ground to determine whether it is independent, tenable, and adequate to support the state court's judgment.

The majority opinion asserts that the entire controversy here turns upon the Florida Supreme Court's decision whether or not to adopt, as state constitutional law, the "realization" doctrine first announced by this Court in 1920 in *Eisner* v. *Macomber*, supra. But that

question was not before the Florida Court for the purpose of establishing a constitutional limitation on the taxing authority of the Florida Legislature. The taxing statutes here in question, incorporating the Federal Internal Revenue Code definition of "taxable income" (See Florida Statutes, Sections 220.11, 12, 13), do not purport to tax appreciation in the value of property until the occurrence of some taxable event recognized by the Federal income tax laws. The doctrine of *Eisner* v. *Macomber* has little, if any relevance to Florida income taxation, except as a rationale for the Florida Supreme Court to rule that unrealized appreciation, not being "income", was not intended to be sheltered from income taxation by the Constitutional Prohibition.

Thus, the sole objective of the Florida Court, in "adopting" *Eisner* v. *Macomber,* was to incorporate it into the Florida constitutional income tax prohibition, as a limitation narrowing the scope of the prohibition itself; and it did so in 1977, under circumstances which give its decision retroactive effect back to 1924, when the prohibition was first incorporated into the state Constitution. The Florida Court rendered this decision six years after the Constitutional Prohibition was prospectively amended so as to remove corporations from its immunity. However, during the years from 1924 to 1971, when the Prohibition was in effect, attracting corporate enterprises into Florida, those corporations understood their rights only from the text of the Constitutional Prohibition itself, as interpreted by *contemporaneous* decisions of the Court. Those decisions, and particularly, *Owens* v. *Fosdick,* 13 So.2d 700 (Fla. 1943), *Mahan* v. *Lummus,* 35 So.2d 725 (Fla. 1948) and *State ex rel McKay* v. *Keller,* 191 So.2d 542 (Fla. 1939)

reveal the Florida Supreme Court's adamant commitment to extend the scope and reach of the prohibition to any and every tax, whether or not denominated an income tax, which either fell upon, or *was measured by*, income. In the *Fosdick* and *Mahan* cases, it even struck down taxes imposed on rights to receive future income. In the *McKay* case, taking the occasion to define "income" as the term was intended in the prohibition, it showed itself to be totally independent of cases (including *Eisner* v. *Macomber*) which defined the term for purposes of the federal tax laws, opting instead for an open-ended definition supplied by Corpus Juris. On brief, and in the argument of this case before the Supreme Court of Florida, Leadership made numerous references to the works of contemporary economists who contend that the term "income", to the economist, includes unrealized appreciation, and not just appreciation which has been separated from capital by a sale. Indeed, in its opinion in this case, the Florida Supreme Court stated:

> "We realize some authorities suggest appreciation constitutionally may be taxed as it occurs. [citations omitted.] Nevertheless, we decline to hold that appreciation as it occurs is income". 343 So.2d at 613, 614.

It is well and good for the Florida Supreme Court to say this in 1977. But what of the rights of those who relied on its pronouncements during the years in which the Prohibition was in effect? Admittedly, there never having been an attempt by the Florida Legislature to tax unrealized appreciation as income, there was never an occasion for the Florida Supreme Court to reject such legislation as being in violation of the Prohibition. Thus, it cannot be said that the decision

here of the Florida Supreme Court amounts to an express overruling of an earlier decision on precisely the same point. Nevertheless, there can be no doubt that the Florida Supreme Court's decision here is in irreconcilable conflict with its earlier decisions mentioned here. While the majority opinion makes no reference whatsoever to those earlier Florida Supreme Court decisions, the dissenting Justices point to the irreconcilable conflict with the decision here on appeal, saying:

> "The judicial decisions heretofore rendered by this Court touching upon constitutional interpretation in general, and the construction to be given to the income-tax prohibition in particular, abundantly support the judgement here reviewed." 343 So.2d at 617. App. "A", p. 11a.

There can be no doubt of the duty and authority of the Florida Supreme Court to interpret Florida's Constitution. But in determining rights under a state constitutional provision which is no longer in effect, particularly in the light of a Federal due process claim that current legislative action unfairly deprives citizens of rights which accrued under that provision, a court should strive to maintain consistency with its former Constructions of that constitutional provision. Such consistency is absent here, and the circumstances suggest a possible attempt to evade Leadership's federal claim, this Court's jurisdiction to review that claim. *Fox River Paper Co. et al.* v. *Railroad Comm. of Wisconsin,* 274 U.S. 651 (1927), *Lawrence* v. *State Tax Commission of State of Mississippi,* 286 U.S. 276 (1932).

Though the Florida Supreme Court appears to have decided this case on a state ground, Leadership con-

tends that that ground is not sufficiently broad to support the Florida Court's judgment. *Murdock* v. *City of Memphis*, 20 Wall. 590 (U.S. 1874), *Eustis* v. *Bolles*, 150 U.S. 361 (1893). There is no doubt that a decision of the 14th Amendment issue by the Florida Supreme Court in Leadership's favor would control the controversy here. The issue thus was one which had to be decided.

It is well established that the otherwise inherent power of the states to tax is subject to restrictions set forth in several provisions of the United States Constitution, the due process clause of the 14th Amendment being one of those. *Frick* v. *Commonwealth of Pennsylvania*, 268 U.S. 473 (1925).

Given the premise that a tax is within the power of the state, questions as to its proper application under the circumstances are purely state questions. *Moffitt* v. *Kelly*, 218 U.S. 400 (1910), *Nickel* v. *Cole*, 256 U.S. 222 (1921). However, questions validly raised under the federal due process clause go to the very power of the state to tax. *Frick* v. *Commonwealth of Pennsylvania, supra.*

A determination by a state court that, as a matter of state constitutional law, appreciation in the value of property cannot be taxed as income until separated from capital by a sale or similar event of "realization", simply does not conclude the question whether a state taxing act, admittedly consistent with that principle, constitutionally can ignore the fact that some of the value appreciation which the act seeks to tax as gain, accrued during a prior period when the legislature lacked constitutional authority to tax in-

come.[2] If the taxing act operates in a manner which is harsh and arbitrary, and may not be reconciled with the due process clause of the federal constitution, it will be invalid whether or not the rule of "realization" is a state constitutional mandate. The Florida Court clearly, but erroneously, thought that its decision respecting the realization doctrine of *Eisner* v. *Macomber* disposed of Leadership's federal due process claim, where it said

> "Holding as we do that there is no income until realization, this argument [due process] is without merit." 343 So.2d at 615, App. "A", p. 10a.

Thus, though the Florida Supreme Court has said that its decision on the "realization" doctrine rendered Leadership's due process objections "without merit", and disposed of the entire controversy, in fact and law, that ruling lacked the breadth to support the decision here appealed from. Thus, it cannot be the basis for defeating the jurisdiction of this Court. *Eustis* v. *Bolles, supra.*

CONCLUSION

To the extent that they tax appreciation which accrued during the period of Florida's Constitutional Income Tax Prohibition, the Florida statutes in question are harsh and arbitrary, and deny Leadership due process of law as guaranteed by the Fourteenth Amendment to the Constitution of the United States.

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[2] The doctrine of *Eisner* v. *Macomber* was a controlling federal constitutional precedent at the time this Court decided *Lucas* v. *Alexander, supra,* and *McLaughlin* v. *Alliance Ins. Co., supra,* which reflects this Court's skepticism as to Congress' power to tax appreciation accruing prior to March 1, 1913.

The importance of the substantative issue here presented, as well as the manner in which Leadership's due process claim was disposed of by the Supreme Court of Florida, merit the noting, by this Court, of its probable jurisdiction in this appeal.

Respectfully submitted,

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Date: May 31, 1977.

APPENDIX

APPENDIX "A"

IN THE SUPREME COURT OF FLORIDA

January Term, A.D. 1977

Case No. 47,440

Circuit Court Case No. 74-6878

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA,
Appellant,

v.

LEADERSHIP HOUSING, INC., and LEADERSHIP COMMUNITIES, INC.,
Appellees.

Opinion filed March 3, 1977

An Appeal from the Circuit Court in and for Broward County, RAYMOND J. HARE, Judge

ROBERT L. SHEVIN, Attorney General; and SYDNEY H. McKENZIE, III, Chief Trial Counsel, for Appellant

RICHARD H. HUNT, JR. and SAMUEL C. ULLMAN of Smathers and Thompson, for Appellees

BRIAN C. ELLIS of Holland and Knight, for Associated Industries of Florida, Inc., Amicus Curiae

JAMES E. MESSER and MITCHELL B. HAIGLER of Thompson, Wadsworth, Messer and Turner, for Morris Trading Corporation, Amicus Curiae

OVERTON, C. J.

This cause is before this Court on direct appeal from a circuit court judgment which declared unconstitutional

provisions of Chapter 220, Florida Statutes (1975). We have jurisdiction.[1]

The issue concerns the validity of the state corporate income tax upon increases in the value of capital assets which occurred prior to November 2, 1971, but were not realized by the sale or transfer of the capital assets until after the effective date of the corporate income tax constitutional amendment and the enactment of the Florida Income Tax Code. We reverse, holding that appreciation in value of a capital asset is not income until it is realized from a sale, exchange or other disposition of the asset, and that the present Florida corporate income tax on such capital gain is constitutional and proper.

The voters of Florida adopted in 1924 a constitutional provision prohibiting any state income tax.[2] That provision remained effectively unchanged until November 2, 1971, when the Florida Constitution was amended to permit imposition of a tax on the income of other than natural persons.[3] Following the amendment, the Florida

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[1] Art. V, § 3(b)(1), Fla. Const.

[2] "Section 11. No tax upon inheritances or upon the income of residents or citizens of this State shall be levied by the State of Florida, or under its authority . . . ." Art. IX, § 11, Fla. Const. (1924).

[3] "SECTION 5. *Estate, inheritance and income taxes.—*

"(a) NATURAL PERSONS. No tax upon estates or inheritances or upon the income of natural persons who are residents or citizens of the state shall be levied by the state, or under its authority, in excess of the aggregate of amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States or any state.

"(b) OTHERS. No tax upon the income of residents and citizens other than natural persons shall be levied by the state, or under its authority, in excess of 5% of net income, as defined by law, or at such greater rate as is authorized by a three-fifths (3/5) vote of the membership of each house of the legislature or as will provide for the state the maximum amount which may be allowed

Legislature enacted the Florida Income Tax Code, Chapter 220, Florida Statutes (1975), which imposed an income tax commencing January 1, 1972, on other than natural persons.

The corporate appellees commenced this action as a suit for declaratory and injunctive relief, seeking a declaration that their capital gains from appreciation of real estate accruing prior to the 1971 constitutional amendment and the enactment of the taxing legislation were constitutionally protected from taxation.

Appellees asserted first that the constitutional prohibition against the taxing of income existing prior to November 2, 1971, precludes the taxation as income of all appreciation in the value of assets accruing prior to that date. Second, the appellees asserted that the levy of an income tax by the State of Florida upon capital appreciation which accrued prior to November 2, 1971, but was realized after that date constitutes harsh, arbitrary, and oppressive taxation in violation of the Due Process Clauses of the Florida and Federal Constitutions.

The trial court agreed with the appellees' contentions and granted summary judgment, holding:

* * *

> "2. The express constitutional prohibition against a state income tax, which was contained in the Florida Constitution until prospectively amended out on November 2, 1971, also prevents any Florida income tax upon increases in the value of property which

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to be credited against income taxes levied by the United States and other states. There shall be exempt from taxation not less than five thousand dollars ($5,000) of the excess of net income subject to tax over the maximum amount allowed to be credited against income taxes levied by the United States and other states.

"(e) Effective Date. This section shall become effective immediately upon approval by the electors of Florida." Art. VII, § 5, Fla. Const.

occurred prior to November 2, 1971, even though such increases in value might be realized through a sale or other taxable transfer of such property after the effective date of the Florida Income Tax Code, Chapter 220 of the Florida Statutes.

"3. The State of Florida did not have the constitutional power to enact a tax on income prior to November 2, 1971. *Appreciation in the value of property which occurred prior thereto continues to be constitutionally protected from taxation as income.* The imposition of a tax upon such appreciation as income constitutes the retroactive operation of an income taxing statute, which retroactive operation impairs constitutionally vested rights without due process of law in violation of Amendment XIV, Section 1 of the Constitution of the United States of America, and Article I, Section 9 of the Constitution of the State of Florida." [Emphasis supplied]

The trial court enjoined the Department of Revenue from levying income tax on the gains at issue, and it allowed the plaintiffs to exclude or deduct gains from their income in

> "an amount equal to the fair market value of such property as of November 2, 1971, for the purpose of restoring that amount to the Plaintiffs free of any Florida income tax."

From that judgment the State Department of Revenue brings this appeal.

The appellees' first contention of unconstitutionality is based on their assertion that the constitutional income tax prohibition in effect from 1924 to 1971 was intended to apply to all income in the broadest sense of the term. They argue appreciation in the value of property is such income, and that the authors and adopters of the consti-

tutional prohibition intended that anything that partook of the nature of income would be protected from taxation. The appellees admit that the effect of their construction and the trial court's order would allow the Legislature to tax as income unrealized accretions in value to capital assets occurring after November 2, 1971, but they assume that the Florida Legislature would decline to tax it.

We realize some authorities suggest appreciation constitutionally may be taxed as it accrues. *See* 1 SURREY & WARREN, FEDERAL INCOME TAXATION, 816-18 and 822-32 (1972); Lowndes, CURRENT CONCEPTIONS OF TAXABLE INCOME, 25 Ohio St. L. J. 151 (1964). Nevertheless, we decline to hold that appreciation as it occurs is income. Such a holding might well be a tax benefit for the appellees, but it could be a tax liability for many others. The appellees' theory would also radically alter the cost bases of many capital assets, requiring such to be changed to the fair market value of the assets on the date of the removal of the constitutional prohibition, or the date of the statutory enactment of the Code. Unlike Section 1053 of the Internal Revenue Code, 26 U.S.C. § 1053, and its predecessors, which awarded cost bases in such assets equal to the greater of either the actual cost of the asset or its fair market value as of the effective date of the first taxing statute, a judicial decision here would not automatically incorporate the option afforded by Congress in selecting the greater of the two bases. The practical effect of the judicial decision asked for by the appellees could require a downward valuation of assets which had depreciated, imposing greater tax liability on some taxpayers.

The entire issue in this case turns on the meaning of income with respect to capital appreciation. Economists and legal scholars are unable to agree whether appreciation in value of a capital asset is income to the asset holder as it accrues or later when it is realized by sepa-

ration from capital. *Compare, e.g.*, Lowndes, CURRENT CONCEPTIONS OF TAXABLE INCOME, *supra*, and H. SIMONS, PERSONAL INCOME TAXATION 88 (1938), *with* Mullock, THE CONSTITUTIONAL ASPECTS OF REALIZATION, 31 U. PITT. L. REV. 615 (1970), and Seligman, 9 AM. ECON. DEVELOPMENT 517 (1919).

The appellant contends that appreciation in value of capital assets is not income until it is realized at the time of disposition, adopting the definition of income in Eisner v. Macomber, 252 U.S. 189 (1920).

We agree and find the proper interpretation is that capital appreciation is not true income until it has been separated from its capital. The separation from capital referred to as the doctrine of "realization" may occur on the receipt of money, other property or rights, or when some other economic benefit is enjoyed by the asset holder. This construction and interpretation follow some economists' theory of the relation of capital to income, specifically that the former is likened to the tree or the land and the latter the fruit or the crop. We approve of the appellant's reliance on Eisner v. Macomber, *supra*, and its concept of when capital appreciation becomes income. The definition contained therein is as follows:

> ". . . 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets . . . .
>
> ". . . [It is] *not* a gain *accruing to* capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital however invested or employed, and *coming in*, being '*derived*,' that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit and disposal;—*that* is income derived from property. Nothing else answers the description." 252 U.S. at 207.

We recognize that the *Eisner* doctrine and definition has been developed to include as realized income such things as (1) the value of a lessee-erected improvement on realty upon reversion of the realty to the lessor, Helvering v. Bruun, 309 U.S. 461 (1940); (2) interest coupons detached from bonds and given as a gift, Helvering v. Horst, 311 U.S. 112 (1940); (3) property transferred by a husband to his wife in a property settlement connected with divorce, United States v. Davis, 370 U.S. 65 (1962). All the aforementioned circumstances constituted events upon which economic gains were enjoyed at the time of the events. No assertion is made in these cases that appreciation in and of itself is taxable. We reject appellees' arguments that the appreciation became immunized from income taxation as it accrued by the Florida constitutional prohibition. We hold that bare appreciation is not income subject to income taxation. The citation by the United States Supreme Court to Eisner v. Macomber and its concept of realization recently in Ivan Allen Company v. United States, 422 U.S. 617, 633 (1975), further convinces us of the correctness of this position. We believe the realization doctrine is the fairest for all taxpayers.

The second point asserted by the appellees is their contention that the tax is harsh and arbitrary. Holding as we do that there is no income until realization, this argument is without merit.[4]

In summary, we hold that appreciation becomes income only upon the sale, exchange, or other disposition of the

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[4] We recognize other courts have decided similar issues on different grounds, but the results have not varied greatly. *See* Norman v. Bradley, 173 Ga. 482, 160 S.E. 413 (1931); City National Bank of Clinton v. Iowa State Tax Commission, 251 Iowa 603, 102 N.W. 2d 381 (1960); Shangri-La, Inc. v. State, 113 N.H. 440, 309 A. 2d 285 (1973); Kellems v. Brown, 163 Conn. 478, 313 A. 2d 53 (1972); Fidelity & Columbia Trust Co. v. Reeves, 287 Ky. 522, 154 S.W. 2d 337 (1941); Fullerton Oil Co. v. Johnson, 39 P. 2d 796 (Ca. 1934); Tiedmann v. Johnson, 316 A. 2d 359 (Me. 1974). *But see* Thorpe v. Mahin, 43 Ill. 2d 36, 250 N.E. 2d 633 (1969).

capital asset together with the accretions thereto, and that such realized gain is income in the year of disposition regardless of when it accrued.

We reverse the trial court, uphold the constitutionality of Chapter 220 as it pertains to the taxation of capital gains accruing prior to November 2, 1971, and dissolve the injunctive order issued by the trial court in this cause.

It is so ordered.

SUNDBERG and HATCHETT, JJ.; and MILLS, District Court Judge, Concur
BOYD, J., Concurs specially with an opinion
ROBERTS (Retired), J., Dissents with an opinion, with which ADKINS, J., Concurs
BOYD, J., Concurring specially.

The dissenting opinion sounds plausible, but those arguments were considered and rejected by the Florida Legislature in 1971 shortly after the income tax amendment to the Constitution was adopted. We are here confronted with the question of whether the law violates the Constitution. I think it does not.

Appellees do not cite any federal or state cases constituting binding precedent to prevent imposition of the tax as enacted by the Legislature. They argue that since many corporations acquired capital assets prior to November 2, 1971, when such income taxes were prohibited by the Florida Constitution, the state is morally and equitably bound not to tax income resulting from increased value prior to that time. I find no basis of estoppel and unfairness here sufficient to enjoin enforcement of the statute. In *City National Bank of Clinton* v. *Iowa State Tax Commission*, 102 N.W.2d 381, 388, substantially the same question was resolved in favor of the state, wherein the Court said:

> "It must be concluded that while capital gains were not included as income in our income tax law prior

> to January 1, 1955, yet the exclusion was little more than an exemption, and the public should have been aware that such exemption could be removed at any session subsequent to the enactment of the income tax law in 1934."

In that case they were dealing with a statute. Here we are considering constitutional provisions. I really see little difference, since both statutes and constitutions can be changed.

In 1930, the section in which the prohibition appeared was amended, but only to permit the Legislature to impose inheritance or estate taxes, to the extent of a credit which might be provided under federal estate tax laws for estate taxes levied and collected by the states. In 1968, the people of Florida adopted a revision of the Florida Constitution. Under that revision, the section containing the income tax prohibition was renumbered, and the language was modified so as to give the Florida Legislature the authority to levy a state income tax, but not in excess of any credit against federal income taxes which might be enacted by Congress in the federal income tax laws. Since the bills then pending in Congress to enact such a federal income tax credit failed, the constitutional condition precedent did not occur, and, thus, the 1968 change in the language of the Florida Constitution has never been given effect.

Although the 1924 amendment prohibited an income tax, appellees should have been aware from the above constitutional changes that the provisions against such taxes were not perpetually frozen in stone. There is simply no basis for this Court to impede the operation of the statute as written.

The critical constitutional determination in this case is that appreciated value accrued by capital assets is not income. Only if the asset is disposed of as contemplated by the statute is income realized. The tax is upon the

income as opposed to being upon the capital asset. It is similar to taxing fruit extracted from trees, but without taxing either the trees or land.

If the consequences of this suit should be limited to the parties and property involved in this litigation, the determination of same by this Court would be less difficult, but this decision will establish a precedent for countless other similar situations. Changing circumstances relating to capital assets due to passing time will render it more difficult as the years pass to determine the true value of property existing in 1971 and to determine increases accruing between that time and the time of the disposition of the property contemplated by the statute. Modifications arising from such matters as market trends, population shifts, zoning, traffic and structural alterations would make it extremely difficult to arrive at the 1971 value years hence. A more reasonable and practicable approach is that espoused by the appellant. Finding no constitutional deficiency in the statute, I am compelled to join in the majority opinion.

ROBERTS, J. (Retired), Dissenting.

I am concerned with the validity *vel non* of the Florida Corporate Income Tax Act, Ch. 220, Fla. Stat., insofar as it may be interpreted as imposing an income tax upon a corporation's capital gain based upon appreciation in the value of its property accruing prior to November 2, 1971.

In declaratory judgment proceedings instituted by the plaintiff-corporations, appellees here, in the court below, the court sustained the plaintiffs' attack upon the validity of the Act and permanently enjoined the defendant, the Department of Revenue of the State of Florida, from "levying, imposing upon or collecting from the Plaintiffs, directly or indirectly, any Florida income tax upon gain resulting from the sale or other taxable transfer of their property, to the extent that such gain represents appre-

ciation in the value of such property occurring prior to November 2, 1971." This appeal by the Department followed. We have jurisdiction of the direct appeal under Section 3(b)(1), Article V. Florida Constitution.

The rationale of the lower court's opinion and judgment was that the express constitutional prohibition against income taxes adopted by the people of this state in 1924 (carried forward in the 1968 Florida Constitution as Section 5, Article VII) prevented the imposition of an income tax based upon increases in the value of property, so that the Legislature's imposition of an income tax on corporations as authorized by an amendment to Section 5, Article VII, supra, adopted November 2, 1971, could not, consistent with due-process requirements of our state and federal constitutions (Section 9, Article I, Florida Constitution, and Section 1, Fourteenth Amendment, United States Constitution), operate retroactively to tax property appreciation occurring prior to November 2, 1971, even though the sale or other transfer of such property which "triggered" the income tax on capital gain for federal income tax purposes (and for the Florida corporate income tax as well, see Section 220.02(4)(a), Florida Statutes) did not occur until after that date.

The judicial decisions heretofore rendered by this Court touching upon constitutional interpretation, in general, and the construction to be given the income-tax prohibition, in particular, abundantly support the judgment here reviewed.

No better expression of the rule with respect to constitutional interpretation can be found than that in Amos v. Mathews, 126 So. 308, 316 (Fla. 1930), as follows:

> "The object of constitutional construction is to ascertain and effectuate the intention and purpose of the people in adopting it. That intention and purpose is the 'spirit' of the Constitution—as obligatory

as its written word. That spirit, however, cannot consist of mere sophistry nor of fanciful or conjectural theory. It must be found in those implications and intendments which clearly flow from the express mandates of the Constitution when considered in the light of circumstances and historical events leading up to its adoption, from all of which the purpose of the people in adopting it is to be gleaned."

And in Fairbank v. U.S., 181 U.S. 283, 21 S.Ct. 648, 45 L.Ed. 862, quoted with approval in Amos v. Mathews, supra, it was said:

> "Constitutional provisions, whether operating by way of grant or limitation, are to be enforced according to their letter and spirit, and cannot be evaded by any legislation which, though not in terms trespassing on the letter, yet in substance and effect destroy the grant or limitation."

These principles have been applied by this Court in construing liberally the income-tax prohibition adopted by the people of this state in 1924. Thus, in State ex rel. McKay v. Keller, 191 So.2d 542 (Fla. 1939), the Court struck down a city ordinance purporting to impose a license tax on attorneys but providing for increased levies based on increased receipts. In ruling that the tax was, in effect, a prohibited tax on income, the court noted that, in giving effect to the rights secured by the Constitution, "the courts are required to consider the substance of things and should not be controlled by form or technical procedure." And in Owens v. Fosdick, 13 So.2d 700 (Fla. 1943), it was held that a tax on the right of the beneficiary of a foreign trust to receive the income for life was an unconstitutional tax on income. Noting that the question of the validity of the tax should be determined "by its operation rather than by its terminology," the Court said:

"If in its practical application, therefore, a tax falls upon that which is prohibited by this section of the Constitution of the State it cannot be upheld, no matter in what terminology the taxing statute is couched, or what the Legislature has declared the tax to be. To be guided by any other view is to concede that what may not be done directly because of constitutional restrictions, may be done indirectly by legislative means accomplishing the same result, the Constitution notwithstanding. Fairbank v. United States, 181 U.S. 283, 21 S. Ct. 648, 45 L. Ed. 862. Constitutional prohibitions may not thus be so lightly evaded or circumvented. Their mandates are imperative, and they must be so construed as to give full force and effect to their manifest purpose. City of Jacksonville v. Continental Can Company, 113 Fla. 168, 151 So. 488."

Accord: Mahan v. Lummus, 35 So.2d 725 (Fla. 1948), relying upon Owens v. Fosdick, supra, in disapproving an income tax on the right of a Florida resident to receive income from a trust estate.

It was said by this Court in State ex rel. West v. Butler, 69 So. 771, 780 (Fla. 1915), that the words or terms used in a Constitution, which is necessarily dependent upon ratification by the people, "must be interpreted in a sense most obvious to the common understanding at the time of its adoption." In 1924, when the Florida constitutional income-tax prohibition was adopted, the concept of "capital gain" as a taxable incident under the Sixteenth Amendment to the federal constitution (authorizing Congress to levy a tax on incomes "from whatever source derived, without apportionment among the States, . . ."), ratified February 25, 1913, and its implementing legislation, the Federal Income Tax Law of 1913 (imposing a tax on income "from all sources," including "gains or profits and income derived from any source

whatever"), had been in effect for more than ten years. And it cannot be doubted that, in adopting the constitutional prohibition against income taxes, the people of this state intended to prohibit the taxation of increases in capital assets, as well as other gains and profits, as income.

It is common knowledge—and a matter of personal knowledge to this writer—that the constitutional prohibition against taxes on inheritances and on incomes was adopted during the so-called Florida "boom" in order to create a favorable tax climate which would attract large investment of capital in this state. It was intended to encourage capital investments by prohibiting "any income tax whatsoever in this State—whether sought to be imposed against a natural person or a corporation." In re Advisory Opinion to Governor, 243 So.2d 573, 578 (Fla. 1971). To break faith with those corporations (and with natural persons, should the people of this state ever see fit to repeal the income-tax prohibition altogether) who invested their capital in this state in reliance on that constitutional covenant would unquestionably be morally wrong and, in our opinion, legally impermissible as violative of the manifest purpose and intent of the 1924 income-tax prohibition and the constitutional rights therein guaranteed.

While, as contended by the appellant, the tax falls technically upon an incident that occurred after the effective date of the 1971 amendment authorizing a tax on corporate income, in its practical application, and as a matter of economic reality, it falls upon an increase in the value of property which was constitutionally protected from a capital gains tax at the time it accrued. And it seems clear that this cannot be done for the simple reason, if no other, that "what may not be done directly because of constitutional restrictions may not be done indirectly by legislative means accomplishing the same result, the

Constitution notwithstanding." Owens v. Fosdick, supra, 13 So.2d at 703.

I have not overlooked the "realization of income" concept of Eisner v. Macomber, 252 U.S. 189, 64 L. Ed. 521, 40 S. Ct. 189, and similar cases, relied upon by appellant in support of its contention that the tax in question is in no way a retroactive tax—that the tax is upon realization of income and that the *time* of accrual of gain is not important. As to this contention it might be said, as did the court in Ivan Allen Co. v. United States, 422 U.S. 617, 45 L. Ed. 435, 95 S. Ct. 2501 (1975), that "we see nothing in the 'realization of income' concept of Eisner v. Macomber . . . that has significance for the issue presently under consideration." The question here is the validity of a Florida income tax based upon appreciation in the value of property that accrued at a time when such a tax was prohibited by the Florida Constitution. Only one of the cases relied upon by appellant, Lynch v. Hornby, 247 U.S. 339, 38 S. Ct. 543 (1918), appears to have involved a tax upon earnings that accrued prior to the effective date of constitutional authorization, and that case may be distinguished. It was concerned with the validity of an income tax upon a cash dividend paid to the stockholder in 1914 out of surplus accumulated prior to March 1, 1913, the effective date of the Federal Income Tax Law—and, presumably, prior to the effective date of the Sixteenth Amendment, February 2, 1913. The court said that, under the Sixteenth Amendment, Congress was authorized to tax as income without apportionment everything that became income in the ordinary sense of the word after the adoption of the Amendment, including dividends received "in the ordinary course" by a stockholder from a corporation, even though they "might appear upon analysis to be a mere realization in possession of an *inchoate and contingent interest* that the stockholder had in a surplus of corporate assets previously existing." (e. s.) (It might be noted, parenthetically, that the Act

was amended in 1916 to exclude from the effect of the tax any dividends declared out of earnings or profits that accrued prior to March 1, 1913.) The court noted that the stockholder and the corporation were two separate entities and that the stockholder had no right or title to the surplus unless or until the directors, in their discretion, should declare a dividend. Accord: Eisner v. Macomber, supra; Lynch v. Turrish, 247 U.S. 221, 38 St. Ct. 537 (1918).

It goes without saying that appreciation in the value of property *owned by the taxpayer* is not an "inchoate and contingent interest" that may or may not be "realized" by the taxpayer. It is sufficiently definite to form the basis for substantial increases in ad valorem taxes based upon increases in the assessed value of the property from year to year, or for a mortgage to secure a loan, or for a financial statement for credit purposes. And in United States v. Davis, 370 U.S. 65, 82 S. Ct. 1190 (1962), it was held to be taxable as income to the husband when transferred to the wife as a part of a property settlement agreement in connection with divorce. See also Helvering v. Bruun, 309 U.S. 461, 60 S. Ct. 631 (1940); Helvering v. Horst, 311 U.S. 112, 61 S. Ct. 144 (1940); Helvering v. Griffiths, 318 U.S. 371, 63 S. Ct. 636 (1943); and James v. U. S., 366 U.S. 213, 81 St. Ct. 1052 (1961), in which the Supreme Court applied the "realization of income" tax concept in various contexts involving economic benefit to the taxpayer other than the taxpayer's personal receipt of money or property.

That the *constitutional* power to tax appreciation in value to the taxpayer's property (as distinguished from the "inchoate interest" of a stockholder in surplus or undivided profits) prior to the actual *statutory* authority to tax is a *sine qua non* to the validity of the tax was made clear, we think, in McLaughlin v. Alliance Ins. Co. of Philadelphia, 286 U.S. 244, 52 S. Ct. 538 (1932). There, the court said:

> "The fact that a part of the taxed gain represented increase in value after . . . [March 1, 1913], but before the present taxing act, is without significance. *Congress, having constitutional power to tax the gain, and having established a policy of taxing it* [cit. om.], may choose the moment of its realization and the amount realized, for the incidence and the measurement of the tax. Its failure to impose a tax upon the increase in the value in the earlier years, assuming without deciding that it had the power, cannot preclude it from taxing the gain in the year when realized, any more than in any other case, where the tax imposed is upon realized, as distinguished from accrued gain . . . ." (e.s.)

And in all of the cases from state courts, cited by appellant, upholding the validity of a state income tax based upon capital appreciation accruing prior to the effective date of the statute imposing the tax, there was no constitutional prohibition that would prevent the imposition of the tax in question. (In fact, among all the fifty states, only Florida's constitution contained a blanket prohibition on the taxation of income, according to Prentice Hall, State and Local Taxes, All States Unit, Par. 101, 1969.) See Fidelity & Columbia Trust Co. v. Reeves, 154 S.W.2d 337 (Ky. 1941); Fullerton Oil Co. v. Johnson, 39 P.2d 796 (Cal. 1934); Kellems v. Brown, 313 A.2d 53 (Conn. 1972); Norman v. Bradley, 160 S.E. 413 (Ga. 1931); Shangri-La, Inc. v. State, 309 A.2d 285 (N. H. 1973); and Riedemann v. Johnson, 316 A.2d 359 (Me. 1974). And it is noteworthy that in the only state case in which a quasi-constitutional inhibition—based on a judicial decision declaring an income tax unconstitutional—existed, the court ruled that the new tax statute was not intended to apply retroactively to capital gains which had accrued prior to the effective date of the new tax statute—apparently to avoid an interpertation that would raise doubts

as to the statute's validity. See Thorpe v. Mahin, 250 N. E. 2d 633 (Ill. 1969).

The Legislature's purpose and intent in adopting the taxpayer's federal income tax return as the basis for the Florida tax in order to simplify the collection of the Florida tax—and thereby minimize the expense to the Department of Revenue and the taxpayer—is understandable. And, concededly, the appellees had no vested right to a continuation of the constitutional income tax prohibition, should the people of this state see fit to repeal it as to corporations. However, for the reasons noted above, their constitutional right to be free of income taxes pending the repeal extends as much to property appreciation upon which a capital gain is based as to rents and profits derived from such property. As noted in Board of Commissioners v. Forbes Pioneer Boat Line, 86 So. 199 (Fla. 1920), the term "vested rights" within the protection of the due process clauses of the state and federal constitutions

> ". . . is not used in any narrow technical sense, or as importing a power of legal control merely, but rather as implying a vested interest which it is right and equitable that the government should recognize and protect, and of which the individual could not be deprived arbitrarily without injustice."

Nor can it be said that the corporate taxpayers of this state should have been reasonably forewarned that unrealized prior gains could be subjected to an income tax at some future date—a test sometimes applied in rejecting a taxpayer's contention that a particular tax which operates retroactively is so unjust and oppresive as to violate due process. See City National Bank of Clinton v. Iowa State Tax Com'n., 102 N.W. 2d 381, 388 (Iowa 1960), and cases cited. In that case, the court was concerned with the Iowa income tax law adopted in 1934, which expressly excluded capital gains from the tax, and

with an amendment to that law adopted in 1955 which imposed the tax on capital gains, and like Florida's tax law, adopted the federal income tax law as the basis for taxing income, including capital gains. Significantly, Iowa had no constitutional prohibition against an income tax. In ruling that the capital gains accruing during the period when the tax was excluded from the income tax—1934 to 1955—could be subjected to the tax, the court said:

> "It must be conceded that while capital gains were not included as income in our income tax law prior to January 1, 1955, yet the exclusion was little more than and exemption, and the public should have been aware that such exemption could be removed at any session subsequent to the enactment of the income tax law in 1934. [cit. om.]

A contrary conclusion was reached in State ex rel. Bundy v. Nygaard, 163 Wis. 307, 158 N. W. 87, 88, ruling that taxation of prior gains, even though unrealized, was so unjust and arbitrary as to be void. In holding the capital gain accruing prior to enactment of income tax law to be immune from such tax, the court said:

> "When the income tax law was first passed in 1911 the stock in question was held by the plaintiff, [It has been bought 4 years before the income tax law was enacted for $110,000 thus a capital gain of $104,000.] and was then of the value of $214,000. This fact is admitted to be established. In the judgment of the court all of this was capital, or, in other words, property. Its status was fixed. No part of it could be made into income by legislative enactment. It was subject to taxation as property under the uniformity rule, but not otherwise. (bracketed portion supplied)

Unlike the taxpayers in the Iowa case, which the court found not to have been "substantially and wrongfully

misled in their belief that under the circumstances existing, accrued capital increases would thereafter be used as the cost basis of such assets rather than the actual cost or the reasonable market value in 1955, or some later date, in computing taxable income," the Florida taxpayers were entitled to rely upon a constitutional immunization of capital gains from a state income tax which was adopted for the very purpose of encouraging them to invest their capital in this state. And, in our opinion, it would be unfair, unjust, and unreasonable to hold that the taxpayers who accepted this state's offer of constitutional immunity from income taxes and invested their capital here had no right to rely upon the state's promises and covenants in this respect—engrafted on to our organic law—and we decline so to do.

For the reasons stated, I respectfully dissent and would affirm the decision of the trial court.

Adkins, J., Concurs

APPENDIX "B"

IN THE CIRCUIT COURT OF THE SEVENTEEN JUDICIAL CIRCUIT
IN AND FOR BROWARD COUNTY, FLORIDA

Case No. 74-6878

LEADERSHIP HOUSING, INC., and LEADERSHIP COMMUNITIES, INC.,
Plaintiffs,

v.

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA,
Defendant.

Amended Final Judgment

This cause came before the Court on the Motions for Summary Judgment of Plaintiffs and Defendant, and the Court having entered its Order granting Plaintiffs' Motion for Summary Judgment and denying Defendant's Motion for Summary Judgment, the Court makes and enters the following findings:

1. This Court has jurisdiction over the subject matter of this cause and over the parties thereto pursuant to Chapter 86 of the Florida Statutes.

2. The express constitutional prohibition against a state income tax, which was contained in the Florida Constitution until prospectively amended out on November 2, 1971, also prevents any Florida income tax upon increases in the value of property which occurred prior to November 2, 1971, even though such increases in value might be realized through a sale or other taxable transfer of such property after the effective date of the Florida Income Tax Code, Chapter 220 of the Florida Statutes.

3. The State of Florida did not have the constitutional power to enact a tax on income prior to November 2, 1971. Appreciation in the value of property which occurred prior thereto continues to be constitutionally protected from taxation as income. The imposition of a tax upon such appreciation as income constitutes the retroactive operation of an income taxing statute, which retroactive operation impairs constitutionally vested rights without due process of law in violation of Amendment XIV, Section 1 of the Constitution of the United States of America, and Article I, Section 9 of the Constitution of the State of Florida.

Wherefore, pursuant to Chapter 86 of the Florida Statutes, the Court determines, declares and decrees as follows:

1. The Florida Income Tax Code, including, without limitation, Sections 220.11, 220.12, 220.13 and 220.02(4) thereof, imposes an income tax on all gain from the sale of property, to the extent such gain is included in taxable income for federal income tax purposes. The tax is imposed upon such gain for the taxable year in which a sale or other taxable transfer of such property occurs, if after January 1, 1972. Since the gain subject to Florida income taxation is quantitatively identical to the gain subject to federal income taxation, appreciation in the value of property which occurred prior to November 2, 1971 becomes subject to Florida income taxation, as gain, at the same time, in the same manner and to the same extent as appreciation occurring after that date.

2. The Florida Income Tax Code, including, without limitation, Sections 220.11, 220.12, 220.13 and 220.02(4) thereof, to the extent it imposes an income tax upon that portion of gain resulting from the sale of property which represents appreciation in the value of such property occurring prior to November 2, 1971, violates Amendment XIV, Section 1 of the Constitution of the United States

of America, and Article I, Section 9 of the Constitution of the State of Florida, and is therefore invalid and void ab initio.

3. In computing, for purposes of the Florida Income Tax Code, taxable gain resulting from the sale of their property, the Plaintiffs are constitutionally entitled to exclude, or deduct, from the amount realized in such sale, an amount equal to the fair market value of such property as of November 2, 1971, for the purpose of restoring that amount to the Plaintiffs free of any Florida income tax.

4. The Defendant Department of Revenue of the State of Flòrida is hereby permanently enjoined from levying, imposing upon or collecting from the Plaintiffs, directly or indirectly, any Florida income tax upon gain resulting from the sale or other taxable transfer of their property, to the extent that such gain represents appreciation in the value of such property occurring prior to November 2, 1971.

5. The Defendant Department of Revenue of the State of Florida is hereby ordered to allow Plaintiffs a deduction or exclusion, consistent with paragraph 3 of this Amended Final Judgment, in computing income subject to tax unfler the Florida Income Tax Code.

6. This Court retains jurisdiction to conduct such further proceedings in this action as may be necessary and proper.

7. Plaintiffs have and recover from Defendant their costs in this action, to be taxed in accordance with applicable law.

DONE AND ORDERED in Chambers at Fort Lauderdale, Florida this 23rd day of April, 1975.

RAYMOND J. HARE
Circuit Court Judge

Copies furnished to:

Richard H. Hunt, Jr.
Smathers & Thompson
Attorneys for Plaintiffs

Sydney H. McKenzie, III
Assistant Attorney General
Attorneys for Defendant

A TRUE COPY

APPENDIX "C"

IN THE SUPREME COURT OF THE STATE OF FLORIDA

Case No. 47,440

Department of Revenue of the State of Florida,
Appellant,

v.

Leadership Housing, Inc., and Leadership Communities, Inc.,
Appellees.

Notice of Appeal to the Supreme Court of the United States

Notice is hereby given that Leadership Housing, Inc., and Leadership Communities, Inc., the Appellees above named, hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of Florida entered in this cause on March 3, 1977, in which this Court reversed the Amended Final Judgment of the Circuit Court of the 17th Judicial Circuit in and for Broward County, entered on April 23, 1975 in the case docketed as number 74-6878, and upheld the constitutionality of Chapter 220, Florida Statutes (1975) as it pertains to the imposition of Florida income taxes on or in respect of unrealized appreciation in property accruing prior to November 2, 1971, and dissolved the injunctive order issued by the Circuit Court in this cause.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

/s/ Richard H. Hunt, Jr.
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APPENDIX "D"

220.02 Legislative intent.—

(1) It is the intent of the legislature in enacting this code to impose a tax upon all corporations, organizations, associations, and other artificial entities which derive from this state or from any other jurisdiction permanent and inherent attributes not inherent in or available to natural persons, such as perpetual life, transferable ownership represented by shares or certificates, and limited liability for all owners. It is the intent of the legislature to subject such corporations and other entities to taxation hereunder for the privilege of conducting business, deriving income, or existing within the state. This code is not intended to tax, and shall not be construed so as to tax, natural persons who engage in a trade or business or profession in this state under their own or any fictitious name, whether individually as proprietorships or in partnerships with others, estates of decedents or incompetents, or testamentary trusts. However, corporations or other taxable entities which are or which become partners with one or more natural persons shall not, merely by reason of being a partner, exclude from their net income subject to tax their respective share of partnership net income. This statement of intent shall be given preeminent consideration in any construction or interpretation of this code in order to avoid any conflict between this code and the mandate in art. VII, § 5 of the state constitution that no income tax shall be levied upon natural persons who are residents and citizens of this state.

(2) It is the intent of the legislature that the tax levied by this code shall be construed to be an excise or privilege tax measured by net income, and that said tax shall not be deemed or construed to be a property tax or a tax on property or a tax measured by the value of property for any purpose.

(3) It is the intent of the legislature that the income tax imposed by this code shall utilize, to the greatest extent possible, concepts of law which have been developed in connection with the income tax laws of the United States, in order to:

(a) Minimize the expenses of the department of revenue and difficulties in administering this code;

(b) Minimize the costs and difficulties of taxpayer compliance; and

(c) Maximize, for both revenue and statistical purposes, the sharing of information between the state and the federal government.

(4) It is the intent of the legislature that the tax imposed by this code shall be prospective in effect only. Consistent with this intention and the intent expressed in subsection (3), it is hereby declared to be the intent of the legislature that:

(a) "Income," for purposes of this code, including gains from the sale, exchange, or other disposition of property, shall be deemed to be created for Florida income tax purposes at such time as said income is realized for federal income tax purposes;

(b) No accretion of value, no accrual of gain, and no acquisition of a right to receive or accrue income which has occurred or been generated prior to November 2, 1971 shall be deemed to be "property," or an interest in property, for any purpose under this code; and

(c) All income realized for federal income tax purposes after November 2, 1971 shall be subject to taxation in full by this state and shall be taxed in the manner and to the extent provided in this code.

(5) It is the intent of the legislature that if there is included in any taxpayer's net income subject to tax under

this code any item or items of income which are determined to be improperly so included because of a conflict with any federal statute, the Constitution of the United States, or the state constitution, all such items of income shall be excluded from the net incomes of all taxpayers subject to tax under this code, but all other provisions of this chapter, and their application, shall not be invalidated or in any way impaired by such required exclusion of an item or items of income.

220.11 Tax imposed.—

(1) A tax measured by net income is hereby imposed on every taxpayer for each taxable year commencing on or after January 1, 1972, and for each taxable year which begins before and ends after January 1, 1972, for the privilege of conducting business, earning or receiving income in this state, or being a resident or citizen of this state. Such tax shall be in addition to all other occupation, excise, privilege, and property taxes imposed by this state or by any political subdivision thereof, including any municipality or other district, jurisdiction, or authority of this state.

(2) The tax imposed by this section shall be an amount equal to 5 percent of the taxpayer's net income for the taxable year.

220.12 Net income defined.—

(1) For purposes of this code, a taxpayer's net income for a taxable year which commences on or after January 1, 1972 shall be that share of its adjusted federal income for such year which is apportioned to this state under § 220.15, less the exemption allowed by § 220.14.

(2) For purposes of this code, a taxpayer's net income for a taxable year which begins before and ends after January 1, 1972 shall be that amount which bears the

same ratio to the taxpayer's share of adjusted federal income which is apportioned to this state for the entire year as the number of days in such year after December 31, 1971 bears to the total number of days in such year, less a like proportion of the exemption allowed by § 220.14, unless the taxpayer elects to compute net income for such taxable year in the manner and under the conditions provided in subsection (3).

(3)(a) If the taxpayer so elects, in the case of a taxable year beginning before and ending after January 1, 1972, there shall be taken into account in computing adjusted federal income, before apportionment, only those items earned, received, paid, incurred, or accrued after December 31, 1971, and the exemption provided by § 220.14 shall be limited to that amount which bears the same ratio to the total exemption allowable under such section, determined without regard to this subsection, as the number of days in such year after December 31, 1971 bears to the total number of days in such year.

(b) The election provided by this subsection shall be made not later than the due date, including any extensions thereof, for filing taxpayer's return for the taxable year, in such manner as the department may by regulation prescribe. However, no such election shall be valid unless the director has given his written approval at the time of such filing or unless the director fails to object to said election in writing within 30 days after such filing.

(c) The method of computing adjusted federal income under this subsection shall be considered extraordinary and shall only be allowed by the director in special situations where the taxpayer has demonstrated that the method for determining net income which is prescribed in subsection (2) will not reasonably reflect that portion of the taxpayer's income attributable to the period after December 31, 1971.

220.13 Adjusted federal income defined.—

(1) "Adjusted federal income" shall mean an amount equal to the taxpayer's taxable income as defined in subsection (2), or said taxable income of more than one taxpayer as provided in § 220.131, for the taxable year, adjusted as follows:

(a) *Additions.*—There shall be added to such taxable income:

1. The amount of income tax paid or accrued as a liability to this state under this code which is deductible from gross income in the computation of taxable income for the taxable year;

2. The amount of interest which is excluded from taxable income under subsection 103(a) of the Internal Revenue Code or any other federal law, less the associated expenses disallowed in the computation of taxable income under subsection 265(2) of the Internal Revenue Code or any other law;

3. In the case of a regulated investment company or real estate investment trust, an amount equal to the excess of the net long-term capital gain for the taxable year over the amount of the capital gain dividends attributable to the taxable year.

(b) *Subtractions.*—

1. In computing the net operating loss deduction allowable for federal income tax purposes under section 172 of the Internal Revenue Code for the taxable year, the net capital loss allowable for federal income tax purposes under section 1212 of the Internal Revenue Code for the taxable year, the excess charitable contribution deduction allowable for federal income tax purposes under section 170 (d)(2) of the Internal Revenue Code for the taxable year, and the excess contributions deductions allowable for federal income tax purposes under section 404 of the

Internal Revenue Code for the taxable year, there shall be subtracted from taxable income, in order to arrive at adjusted federal income, such amounts as reflect the following limitations:

a. No deduction shall be allowed for net operating losses, net capital losses, and excess contribution deductions under sections 170(d)(2) and 404 of the Internal Revenue Code which are carried forward from taxable years ending prior to January 1, 1972; and

b. The net operating loss, net capital loss, and excess contributions deductions under sections 170(d)(2) and 404 of the Internal Revenue Code, respectively, allowable for any taxable year beginning before and ending after January 1, 1972 shall be limited to an amount which bears the same ratio to the taxpayer's net operating loss, net capital loss, and excess contributions deductions under sections 170(d) (2) and 404 of the Internal Revenue Code, respectively, for the entire taxable year as the number of days in such year after December 31, 1971 bears to the total number of days in such year, unless the taxpayer elects to account separately for income under subsection 220.12 (3) of this code, in which case the net operating loss, net capital loss, and excess contributions deductions under sections 170(d)(2) and 404 of the Internal Revenue Code, respectively, allowable for such year shall be determined on the basis of the items actually earned, received, paid, incurred, or accrued after December 31, 1971; and

c. A net operating loss and a capital loss shall never be carried back as a deduction to a prior taxable year, but all deductions attributable to such losses shall be deemed net operating loss carryovers and capital loss carryovers, respectively, and treated in the same manner, to the same extent, and for the same time periods as are prescribed for such carryovers in section 172 and section 1212, respectively, of the Internal Revenue Code.

2. There shall be subtracted from such taxable income any amount included therein:

a. Under section 78 or section 951 of the Internal Revenue Code;

b. Which was derived from sales outside the United States, and from sources outside the United States as interest, as a royalty, or as compensation for technical or other services; and

c. Which was received as a dividend from a corporation which neither transacts any substantial portion of its business in the United States nor regularly maintains any substantial portions of its assets within the United States.

However, as to any amount subtracted under this subparagraph, there shall be added to such taxable income all expenses deducted on the taxpayer's return for the taxable year which are attributable, directly or indirectly, to such subtracted amount.

(c) *Installment sales.*—

1. Unless there has been an election under subparagraph 2., any taxpayer which returns any portion of its income for federal income tax purposes under section 453 of the Internal Revenue Code, whether or not as a dealer, shall file its return under this code, and shall compute its adjusted taxable income, including income derived from transactions treated for federal tax purposes as installment sales, in accordance with the regular method by which the taxpayer accounts, under section 446(c) of the Internal Revenue Code, for transactions which are not installment sales. In preparing its return under this code, the taxpayer shall adjust taxable income, as defined in subsection (2), by excluding therefrom all installment sale income reported in the taxable year with respect to income realized from installment sales prior to January 1, 1972 and by including therein the full amount of all income realized from installment sales, under an accrual method

of accounting, on or after said date. However, for a taxable year which begins before and ends after January 1, 1972, the ratio set forth in subsection 220.12 (2) shall not be applied to the taxpayer's apportioned share of installment sale income in computing net income.

2. Any taxpayer which has elected for federal income tax purposes to report any portion of its income on the installment basis under section 453 of the Internal Revenue Code may elect so to return income from installment sales for purposes of this code. However, the election provided by this subparagraph shall only be allowed if:

a. The election is made not later than the due date, including any extensions thereof, for filing the taxpayer's return under this code, in such manner as the department may prescribe; and

b. The taxpayer consents in writing, at the time of its election, to the filing of its return without the adjustments to taxable income which are described in subparagraph 1.

3. If the taxpayer is a dealer or otherwise returns a portion of its income under section 453 of the Internal Revenue Code, an election under subparagraph 2. must be made for the taxpayer's first taxable year under this code in which a portion of its income is so returned for federal tax purposes, and said election shall apply to all subsequent taxable years for which installment sale treatment is elected for federal income tax purposes, unless the department consents in writing to the revocation of such election prior to the first taxable year for which such revocation would apply.

4. If an election is made under subparagraph 2., then, in lieu of returning the entire amount of installment sale income returned for federal income tax purposes, the taxpayer may include in income for each taxable year under this code only the amount of income which is specified in subparagraph 5., in which event the taxpayer shall also

add to taxable income, as defined in subsection (2), all expenses deducted on its federal return for the taxable year with respect to installment sale income excluded from Florida net income under this provision, including collection costs and the expenses attributable to serving sales contracts.

5. The amount to be included in taxable income under subparagraph 4. shall be limited to the sum of the following amounts:

a. An amount equal to 100 percent of the income derived from installment sale transactions consummated on or after January 1, 1972;

b. An amount equal to 70 percent of the income returned for federal income tax purposes in the taxable year which was derived from installment sale transactions consummated prior to January 1, 1972 and after December 31, 1970;

c. An amount equal to 50 percent of the income returned for federal income tax purposes in the taxable year which was derived from installment sale transactions consummated prior to January 1, 1971 and after December 31, 1968;

d. An amount equal to 25 percent of the income returned for federal income tax purposes in the taxable year which was derived from installment sale transactions consummated prior to January 1, 1969 and after December 31, 1966; and

e. An amount equal to 10 percent of the income returned for federal income tax purposes in the taxable year which was derived from installment sale transactions consummed prior to January 1, 1967.

6. The department may by regulation prescribe the methods or procedures for computing the amounts included and excluded from taxable income under subparagraphs 4. and 5.

(2) For purposes of this section, a taxpayer's taxable income for the taxable year shall mean taxable income as defined in section 63 of the Internal Revenue Code and properly reportable for federal income tax purposes for the taxable year, but subject to the limitations set forth in paragraph (1)(b) with respect to the deductions provided by sections 172 (relating to net operating losses), 170(d)(2) (relating to excess charitable contributions), 404(a)(1)(D) (relating to excess pension trust contributions, 404(a)(3)(A) and (B) (to the extent relating to excess stock bonus and profit-sharing trust contributions), 404(d) (relating to excess contributions under the 1939 code) and 1212 (relating to capital losses) of the Internal Revenue Code, except that, subject to the same limitations:

(a) "Taxable income," in the case of a life insurance company subject to the tax imposed by section 802 of the Internal Revenue Code, shall mean life insurance company taxable income; however, the amount of said income determined under paragraph 802(b)(3) of the Internal Revenue Code which shall be taken into account for purposes of this code shall never exceed, cumulatively, the excess of amounts determined under said paragraph as of the close of the taxpayer's taxable year over the amount determined under said paragraph as of December 31, 1971;

(b) "Taxable income," in the case of a mutual insurance company subject to the tax imposed by section 821 (a) or (c) of the Internal Revenue Code, shall mean mutual insurance company taxable income or taxable investment income, as the case may be;

(c) "Taxable income," in the case of an insurance company subject to the tax imposed by section 831(a) of the Internal Revenue Code, shall mean insurance company taxable income;

(d) "Taxable income," in the case of a regulated investment company subject to the tax imposed by section

852 of the Internal Revenue Code, shall mean investment company taxable income;

(e) "Taxable income," in the case of a real estate investment trust subject to the tax imposed by section 857 of the Internal Revenue Code, shall mean real estate investment trust taxable income;

(f) "Taxable income," in the case of a corporation which is a member of an affiliated group of corporations filing a consolidated income tax return for the taxable year for federal income tax purposes, shall mean taxable income of such corpoartion for federal income tax purposes as if such corporation had filed a separate federal income tax return for the taxable year and each preceding taxable year for which it was a member of an affiliated group, unless a consolidated return for the taxpayer and others is required or elected under § 220.131;

(g) "Taxable income," in the case of a cooperative corporation or association, shall mean the taxable income of such organization determined in accordance with the provisions of section 1381 through 1398 of the Internal Revenue Code;

(h) "Taxable income," in the case of an organization which is exempt from the federal income tax by reason of section 501(a) of the Internal Revenue Code, shall mean its unrelated business taxable income as determined under section 512 of the Internal Revenue Code; and

(i) "Taxable income," in the case of a corporation for which there is in effect for the taxable year an election under section 1372 of the Internal Revenue Code, shall mean the amount of income subject to tax at the corporate level under paragraph 1372(b)(1) of the Internal Revenue Code for each taxable year.

APPENDIX "E"

IN THE CIRCUIT COURT OF THE SEVENTEENTH JUDICIAL CIRCUIT
IN AND FOR BROWARD COUNTY, FLORIDA.

CASE NO. 74-6878

LEADERSHIP HOUSING, INC. and LEADERSHIP
COMMUNITIES, INC., *Plaintiffs*

v.

DEPARTMENT OF REVENUE OF THE
STATE OF FLORIDA, *Defendant.*

Notice of Appeal to the Supreme Court of the United States

Notice is hereby given that LEADERSHIP HOUSING, INC., and LEADERSHIP COMMUNITIES, INC., the Plaintiffs above named, hereby appeal to the Supreme Court of the United States from the final judgment of the Supreme Court of Florida entered on March 3, 1977, in the cause numbered 47,440 in the Supreme Court of Florida in which cause the Department of Revenue of the State of Florida was Appellant and Leadership Housing, Inc. and Leadership Communities, Inc., were Appellees, and in which cause the Supreme Court of Florida reversed the Amended Final Judgment of the Circuit Court of the 17th Judicial Circuit in and for Broward County, Florida, entered on April 23, 1975 in the above entitled cause docketed as number 74-6878, and upheld the constitutionality of Chapter 220, Florida Statutes (1975) as it pertains to the imposition of Florida income taxes on or in respect of unrealized appreciation in property accruing prior to November 2, 1971, and dissolved the injunctive order issued by the Circuit Court in this cause.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Respectfully submitted,

/s/ RICHARD H. HUNT, JR.
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(PROOF OF SERVICE OMITTED IN PRINTING)

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1976

NO. 76-1699

LEADERSHIP HOUSING, INC., and LEADERSHIP COMMUNITIES, INC.,
Appellants,

v.

DEPARTMENT OF REVENUE OF THE STATE OF FLORIDA
Appellee.

ON APPEAL FROM THE SUPREME COURT OF THE STATE OF FLORIDA

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MOTION TO DISMISS OR AFFIRM

Appellee moves this Court to dismiss the appeal herein or, in the alternative, to affirm the judgment of the Supreme Court of Florida on the grounds that it is manifest that the decision below rests on adequate state grounds and that the question on which this appeal

depends is so insubstantial as to not need further argument.

STATEMENT OF THE CASE

A. STATE CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED AND NATURE OF THE CASE.

This appeal questions the validity of Florida's Income Tax Code, Chapter 220, Florida Statutes.

To facilitate an understanding of the nature of this appeal, it is necessary to refer to the history of certain provisions of the Florida Constitution.

Article IX of the Florida Constitution of 1885 was amended in 1924 by the addition to Article IX of Section 11, which read:

> No tax upon inheritances
> or upon the income of

> residents or citizens of this State shall be levied by the State of Florida, or under its authority, and there shall be exempt from taxation to the head of a family residing in this State, household goods and personal effects to the value of Five Hundred ($500.00) Dollars.

The above language continued unchanged until the 1968 Constitutional revision. As approved in the general election on November 5, 1968, new Article VII, Section 5, read:

> No tax upon estates or inheritances or upon the income of residents or citizens of the state shall be levied by the state, or under its authority, in the excess of the aggregate of amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States or any state.

The above-quoted provisions will hereafter be referred to as the "Prohibition."

The terms "residents" and "citizens" in the 1968 version were interpreted by the Florida Supreme Court to extend to corporations protection from income taxation. In re Advisory Opinion to the Governor, 243 So.2d 575 (1971). Thereafter, on November 2, 1971, the following amendment to Article VII, Section 5, was approved in the general election:

> (a) NATURAL PERSONS. No tax upon estates or inheritances or upon the income of natural persons who are residents or citizens of the state shall be levied by the state, or under its authority, in excess of the aggregate of amounts which may be allowed to be credited upon or deducted from any similar tax levied by the United States or any state.
>
> (b) OTHERS. No tax upon the income of residents

and citizens other than natural persons shall be levied by the state, or under its authority, in excess of 5% of net income, as defined by law, or at such greater rate as is authorized by a three-fifths (3/5) vote of the membership of each house of the legislature or as will provide for the state the maximum amount which may be allowed to be credited against income taxes levied by the United States and other states. There shall be exempt from taxation not less than five thousand dollars ($5,000) of the excess of net income subject to tax over the maximum amount allowed to be credited against income taxes levied by the United States and other states.

(c) EFFECTIVE DATE. This section shall become effective immediately upon approval by the electors of Florida.

Under the authority of this amendment, the Florida Legislature enacted Chapter 220, Laws of Florida, entitled the "Florida Income Tax Code," imposing a corporate income tax effective January 1, 1972. The relevant provisions of Chapter 220, supra, are set forth in Appendix "D" to the Jurisdictional Statement. The summarized effect of those provisions can be stated as follows: The Florida Legislature did not include in the Income Tax Code a deduction of any kind for that portion of the gain from the sale of property, otherwise included in federal taxable income, which occurred prior to the date of the constitutional amendment removing the Prohibition from the Florida Constitution. By reason of the absence of any provision permitting such a deduction, appreciation in the value of property which occurred prior

to the amendment is taxed, along with the appreciation in value which occurred after that date. Thus, the clear intent of the Legislature was to include all accretions to value, whether occurring before or after November 2, 1971, in the taxable income from capital gains under the Florida Code. This is conceded by Appellants.

The Appellant, LEADERSHIP HOUSING, INC., is a Delaware corporation, with its principal office located in Broward County, Florida. The Appellant, LEADERSHIP COMMUNITIES, INC., is a Florida corporation, also with its principal office in Broward County, Florida. Both Appellants are admittedly subject to the income tax imposed by Chapter 220, Laws of Florida, and have been subject thereto since the enactment of that

statute. They are referred to hereinafter collectively as "Leadership" or Appellants.

Each of the Appellants is engaged in the business of purchasing, developing and selling land to its customers. They acquired various tracts of land in Florida between the year 1924 and the amendment date. Certain portions of such land were sold by Appellants during the taxable years 1972 and 1973.

B. PROCEEDINGS BELOW

Suit was instituted by Leadership in the Circuit Court of the Seventeenth Judicial Circuit of Florida against the Department of Revenue of the State of Florida. The suit was instituted pursuant to Section 86.021, Florida Statutes, seeking a declaratory judgment and other supplemental relief.

Leadership sought to have the Court declare Chapter 220, Laws of Florida, unconstitutional and void ab initio, to the extent that it authorizes a levy of income taxation upon appreciation (whether at the time of its realization or its recognition for Federal income tax purposes), which represents gain in value accrued prior to November 2, 1971, the effective date of the amendment to Section 5 of Article VII, Florida Constitution, authorizing a tax upon the income of corporations.

Upon cross-motions for summary judgment, the trial court granted summary judgment in favor of Leadership and on April 23, 1975, granted an amended final judgment declaring Chapter 220, Laws of Florida unconstitutional under the due process clauses of the Florida Constitution and the Constitution of the United

States. The Department of Revenue, Appellee before this Court, entered a timely appeal to the Supreme Court of Florida. The Florida Supreme Court reversed the trial court and Leadership instituted this appeal.

ARGUMENT

POINT I

THE DECISION BELOW RESTS ON STATE-LAW GROUNDS WHICH ARE ADEQUATE AND ENTIRELY DISPOSITIVE OF ALL ISSUES BEFORE THE SUPREME COURT OF FLORIDA.

On appeal to the Florida Supreme Court, Leadership raised on additional ground to support the trial court's decision holding the Income Tax Code invalid. Leadership asserted that

the Prohibition forever shielded from income taxation appreciation in the value of capital assets as such appreciation arose. Essentially Leadership contended that the term "income," as contained in the Prohibition and as interpreted by Florida decisional law during the existence of the Prohibition, included appreciation in capital, although that appreciation had not been realized as gain by the sale of the capital asset during the pendency of the Prohibition. Leadership contended that any subsequent attempt to tax such previously accrued appreciation was barred by the Prohibition, although repealed.

Thus, the Florida Supreme Court stated the issues before it as follows:

> Appellees asserted first that the constitutional prohibition against

> the taxing of income existing prior to November 2, 1971, precludes the taxation as income of all appreciation in the value of assets accruing prior to that date. Second, the appellees asserted that the levy of an income tax by the State of Florida upon capital appreciation which accrued prior to November 2, 1971, but was realized after that date constitutes harsh, arbitrary, and oppressive taxation in violation of the Due Process Clauses of the Florida and Federal Constitutions.

Department of Revenue v. Leadership Housing, Inc., 343 So.2d 611, 613 (Fla. 1977). It is critical to observe that the first issue turns upon the construction of the word "income" in the repealed Prohibition and upon resolving the question of whether that definition differs from the meaning of "income"

as it has been historically used in federal income tax statutes and, as it is now used in the Florida Income Tax Code. That issue is one completely of state law.

The Florida Supreme Court addressed itself to that issue first and exclusively. Department of Revenue v. Leadership Housing, Inc., supra, at 613, 614 ("The entire issue in this case turns on the meaning of income with respect to capital appreciation.") The court reviewed the authorities on the question and concluded that the term "income" in the repealed Prohibition had the meaning historically given to that term by most authorities:

> " 'Income may be defined as the gain derived from capital, from labor, or from both combined' provided it be understood to include

profit gained through
a sale or conversion
of capital assets. . . .
Here we have the
essential matter: not
a gain accruing to capital,
not a growth or increment
of value in the investment;
but a gain, a profit,
something of exchangeable
value proceeding from the
property, severed from
the capital . . . and,
coming in, being 'derived,'
that is received or drawn
by the recipient (the tax-
payer) for his separate
use, benefit, and disposal.
That is income derived from
property. Nothing else
answers the description."

Eisner v. Macomber, 25 U.S. 189, 207-08 (1919). (emphasis in original). See also Helvering v. Griffiths, 318 U.S. 371, 63 S.Ct. 636, 87 L.Ed. 843 (1943); MacLaughlin v. Alliance, Ins. Co. of Philadelphia, 286 U.S. 244, 52 S.Ct. 538, 76 L.Ed. 1083 (1932).

The construction of the term "income" in the decision below thus

disposed of Leadership's contention under the Florida constitution. Since income, as used in the Prohibition did not include bare appreciation, as it accrued, then such capital accretions were not isolated from later taxation when the appreciation was realized as a capital gain through sale or conversion after the Prohibition had been repealed. Having decided the question of construction against Leadership, the Florida Supreme Court addressed the federal question in the following terse passage:

> "The second point asserted by the appellees is their contention that the tax is harsh and arbitrary. Holding as we do that there is no income until realization, this argument is without merit." 343 So.2d 611 at 615 (footnote omitted).

The final paragraph of the opinion below states as follows:

"We reverse the trial court, uphold the constitutionality of Chapter 220 as it pertains to the taxation of capital gains accruing prior to November 2, 1971, and dissolve the injunctive order issued by the trial court in this cause."

Id. Although the decision below referred to the federal question as having no "merit" and upheld the constitutionality of the Florida Income Tax Code, the structure of the opinion makes it clear that the federal issue need not have been and was not reached on its merits and that the reference to the constitutionality of Chapter 220, Laws of Florida, related to constitutionality under the organic law of Florida.

The operative jurisdiction principle is concisely stated in this Court's decision in Honeyman v. Hanan:

"It is a well established principle of this Court that before

> we will review a decision of a state court it must affirmatively appear from the record that the federal question was presented to the highest court of the State having jurisdiction and that its decision of the federal question was <u>necessary</u> to its determination of the cause." (emphasis added).

300 U.S. 14, 18 (1937). It is clear from decisions of this Court that review will be denied where it is not demonstrated that a decision on the federal ground was necessary to the decision appealed. <u>Flournoy v. Weiner</u>, 321 U.S. 253, 64 S.Ct. 548, 88 L.Ed. 708 (1944). <u>See also</u> <u>Armstrong v. Armstrong</u>, 305 U.S. 568, 76 S.Ct. 629, 100 L.Ed. 705 (1956). The <u>Armstrong</u> decision involved a challenge to the divorce decree of an Ohio court granting alimony. Prior to the Ohio decision, a Florida Court had entered a divorce decree between the

same parties and had specifically decreed that no alimony would be awarded. On appeal, the Ohio decision was challenged as failing to give full faith and credit to the Florida decree. In this Court's opinion, it was found that the decree from Florida, although facially explicit, was ambiguous given the posture of the case before the Florida court. The denial of alimony could have resulted from a determination that an award would be unfair or from a lack of evidence to support a reasonable award. Taking the latter interpretation, the Court avoided the federal challenge and affirmed the Ohio court.

In addition to the above authorities, this Court's decision in Fox Film Corp. v. Muller, 296 U.S. 207 (1935), makes clear that where a decision

on state grounds below removes the necessity for considering the federal question or leaves only a purely formal federal question, review will be denied. That is precisely the situation presented by the appeal at bar.

There are two possible federal issues presented by Leadership's invocation of the due process clause of the Fourteenth Amendment. Firstly, there is raised the contention that the tax in question is excessively retroactive and harsh, being therefore contrary to due process. However, that issue is purely formal. The law has been settled, by decisions of this court and by the great weight of decisions from other tribunals, that a tax which calculates income to include capital gains accruing but not realized prior to the date of enacement of the tax is not unconstitutionally

retroactive. See, e.g., Lynch v. Hornsby, 247 U.S. 339, 38 S.Ct. 543, 62 L.Ed. 1149 (1917); MacLaughlin v. Alliance Ins. Co., supra; Kellems v. Brown, 163 Conn. 478, 313 A.2d 53 (1972); Fullerton Oil Co. v. Johnson, 2 Cal.2d 162, 39 P.2d 796 (1934); Fidelity Trust Co. v. Reeves, 287 Ky. 522, 154 S.W.2d 337 (1941); City Nat'l Bank of Clinton v. Iowa State Tax Comm'n, 102 N.W. 2d 381 (Iowa 1960); Norman v. Bradley, 173 Ga. 482, 160 S.E. 413 (1931); Sweetland v. Franchise Tax Bd., 192 Cal App.2d 316, 13 Cal Rep. 432 (1961); Olivey v. Collector of Revenue, 223 La. 985, 97 So.2d 317 (1958); Tiedemann v. Johnson, 316 A.2d 359 (Me. 1974); Shangri-La, Inc. v. State, 309 A.2d 285 (N.H. 1973). Thus, the basic proposition as established in both state and federal constitutional law is that an increase

in value of property over its acquisition value, when realized by conversion into money or other property, constitutes profit which has been consistently regarded as income and taxable when so realized. In other words, the incident or triggering event of taxation is the realization of the gain by sale or other disposition. The Florida Income Tax Code taxes only those events occurring after the effective date of the Act, January 1, 1972, and is prospective. The measure of the tax is the amount of gain over the initial base value, but as well explained in Kellems v. Brown, supra, this does not constitute retroactivity. The gain on which the tax is imposed, under the concepts clearly recognized by the courts, occurs entirely after the effective date of the Act and the

constitutional amendment. Leadership's attempt to avoid the import of MacLaughlin v. Alliance Ins. Co., supra, Lynch v. Hornsby, supra, and authorities of like ilk cannot be sustained. Brushaber v. Union P.R. Co., 240 U.S. 1 (1916); Southern Pacific Co. v. Lowe, 247 U.S. 330 (1918); Lynch v. Turrish, 247 U.S. 221 (1918), and Lucas v. Alexander, 279 U.S. 573 (1929), cited by Leadership at page 15 of the Jurisdictional Statement, rest entirely on the construction of statutory, not constitutional, limitations.

Lynch v. Hornsby, supra, closely on point, permitting the taxing of capital gains accruing prior to the effective date of the Sixteenth Amendment, is not mentioned in Leadership's Jurisdictional Statement.

Under Fox Film Corp. v. Muller, supra, so purely formal a federal question does not present an appealable issue even if addressed in the state court's decision.

A second federal question ostensibly presented under the due process clause of the Fourteenth Amendment, distinguished from the argument that this tax is retroactive, is that Leadership and other Florida taxpayers were beguiled by the existence of the Prohibition and justifiably relied on prior decisions of the Florida courts enterpreting the term "income" in the Prohibition as including capital appreciation as it arose, so that to now tax appreciation which accrued prior to the repeal of the Prohibition is arbitrary and unfair. That this is the only due process claim which is even remotely

colorable is evident from the number of times the argument is vehemently repeated in the Jurisdictional Statement.

Obviously, however, this latter issue cannot arise unless one first construes the Prohibition in favor of Leadership. Indeed, the federal issue, to arise at all, must be preceded by an interpretation, not only of the Prohibition itself, but of prior Florida case law construing the Prohibition. Thus, it can be seen that the existence of the federal question presented for decision in this appeal pivots upon the solution in Leadership's favor of an antecedent state-law issue; the construction of the Prohibition.

In the Jurisdictional Statement, Leadership attempts to avoid this inexorable point by characterizing the

decision below as itself retroactive, arbitrary and unfair, as an attempt to evade review by this Court. In fact, Leadership attempts to set up an additional federal question for review without formally stating it - that the decision below itself violates due process by somehow retroactively changing the definition of income.

When that argument is made clear, it becomes obvious that Leadership seeks to have this Court review the interpretation of Florida law by the Florida Supreme Court. Moreover, the attempt is made under the guise of presenting a federal question which cannot even arise unless the underlying interpretational issue is decided as Appellant's wish.

This Court must accept the Florida Supreme Court's interpretation of

the term "income" in the Prohibition unless compelling circumstances exist which warrant disregarding it. Guaranty Trust Co. v. Blodgett, 287 U.S. 509 (1933). None exist here. Appellants concede that the meaning of income in the Prohibition as construed by the decision below is not directly in conflict with any prior Florida decision construing the Prohibition. p. 23-24, Jurisdictional Statement. Nevertheless, Appellants strive without avail to demonstrate a conflict between the decision appealed and prior Florida cases on the Prohibition. An examination of the cases cited by Appellants as creating the conflict reveals that none exists.

In State v. Keller, 191 So. 542 (Fla. 1939) (p. 6, Jurisdictional Statement), the court found that a city ordinance imposing a graduated license

on tax attorneys and other professionals calculated upon the amount of net income earned in the preceding year was an income tax and struck it down. However, that decision did not even remotely address the question "What is income?" Much less did it approach the task of defining the meaning of income in respect to capital appreciation. Rather, the sole question for decision was whether the tax, as measured _by_ actual income received was _on_ income in violation of the Prohibition.

In _Owens v. Fosdick_, 13 So.2d 700 (Fla. 1943) (p. 5, Jurisdictional Statement), the court struck down an intangible property tax as applied to the right of a resident beneficiary of a foreign trust to receive purely interest from the trust. The court found that the tax as applied, was one on income.

However, the nature of the subject taxed clearly met the definition of income articulated in the case at bar. The beneficiary in Owens v. Fosdick, supra, had the right to receive only income generated by and separate from the trust res; no right to invade the res, to have it sold or converted to income was given by the settlor. Thus, the matter of defining income in relation to capital accretions was not before the court in Owens v. Fosdick, supra. Indeed, the case dismisses and distinguishes another Florida decision wherein application of the intangible property tax was upheld because the beneficiary had the right to invade the trust corpus virtually at will in addition to the right to receive income from the trust. If anything, the decision in Owens v. Fosdick, supra, suggests that, all along,

the Florida Courts have understood the distinction between capital growth (property) and income from capital in the form of interest, or in the form of capital gain at the time of sale or conversion of the capital asset. That understanding is entirely supportive of the definition given to income in the decision here on appeal. The same is true of Mahan v. Lummus, 35 So.2d 725 (Fla. 1948) (p. 6, Jurisdictional Statement).

There being no hint that the instant decision below conflicts in any way with prior rulings, this Court must accept the decision appealed from for what it is: a ruling premised upon and concerned with the interpretation of Florida law. The resolution of that interpretation against Appellants concludes the predicate for review of the

federal claim here presented. Given the interpretational ruling below, the federal question never became more than a ghost in the wings, despite Appellant's strenuous protestations that it occupied center stage.

POINT II

THIS APPEAL RAISES NO SUBSTANTIAL FEDERAL QUESTION.

This appeal revolves around this central issue: The question is basically whether the levy of an excise tax on the privilege of doing business in Florida where the incident of taxation is the sale, exchange or other disposition of property, and the measurement of the tax is the amount of gain at the time of sale, exchange or other disposition of the property over the base value at the time of acquisition, is a retroactive tax. If it is not retroactive, then it

obviously is not unconstitutionally retroactive. Appellants are unable to assert any significant direct authority for the proposition that such a tax is retroactive. The Court should keep in mind the basic proposition which has been established in challenges based on the argument of retroactivity for taxes similar in nature to that before the Court here. A clear summary of the law as adopted by the federal courts and virtually all state courts on this issue is well set out in Kellems v. Brown, 163 Conn. 478, 313 A.2d 53 (1972), where the court in dealing with a similar provision stated:

> We find no indication either in the language of the act itself or in its legislative history that the General Assembly intended to adopt any other standard for

taxing capital gain than that employed for federal tax purposes to which standard the act makes specific reference. Only gains realized after December 31, 1970, are taxed under the act. The fact that the amount of the tax depends, among other things, on the cost of the asset which may have been acquired prior to the enactment of the tax does not make the tax retrospective. The tax being imposed at the time of realization of the gain operates only in the prospective manner

* * *

The plaintiffs argue that the act so interpreted violated the due process of law provisions of the United States and Connecticut constitutions. Their argument is, essentially, that a taxpayer's cost basis may have as its origin a transaction or valuation which took place over fifty years ago and thus the tax imposed on the profit resulting from the sale of the asset is not only retroactive but

> excessively so and constitutes a denial of due process. This argument, however, disregards the concept of taxation of the realization of the capital gain. While the value of a taxpayer's property may increase over a period of years, he realizes the profit and capital gain only on the sale or exchange of the property. The established concept of capital gain taxation and as it is implemented in the act is that the tax is levied on the dual transaction, not on the gradual accretion in value.

This is consistent with virtually all other authority on the point. <u>See</u> <u>MacLaughlin v. Alliance Insurance Co. of Philadelphia</u>, 286 U.S. 244, 52 S.Ct. 538, 76 L.Ed. 1083 (1932). <u>See also</u> <u>Fullerton Oil Co. v. Johnson</u>, 2 Cal.2d 162, 168, 39 P.2d 796 (Cal. 1934); <u>Fidelity Columbia Trust Co. v. Reeves</u>, 287 Ky. 522, 154 S.W.2d 337

(Ky. 1941); City National Bank of Clinton v. Iowa State Tax Com'n., 102 N.W.2d 381 (Iowa 1960); Norman v. Bradley, 173 Ga. 482, 160 S.E. 413 (Ga. 1931); Sweetland v. Franchise Tax Board, 192 Cal. App.2d 316, 13 Cal. Rep. 432 (1961); Olivey v. Collector of Revenue, 233 La. 985, 99 So.2d 317 (1958); Tiedemann v. Johnson, 316 A.2d 359 (Me. 1974); Shangri-La, Inc. v. State, 309 A.2d 285 (N.H. 1973).

Appellants seek to avoid the obvious jurisdictional impolications of this host of authority by advancing essentially two arguments.

Appellants first content that the instant appeal is factually unique and distinguishable from the overwhelming authority plainly contrary to their position. Appellants argue that, because the impediment to the imposition of an

income tax was contained in a State constitutional provision, somehow this case is <u>sui generis</u> and not controlled by the authorities cited above. In essence, this argument is but one species of the "forewarning doctrine" which Appellants seek to make applicable to this case. However, this argument stands foreclosed both by logic and authority.

As noted in the concurring opinion of Justice Boyd to the decision below, there is no significant distinction to be drawn merely because in this case a state constitutional provision provided an exemption from income taxation, while the other authorities on point involved state statutes. <u>Department of Revenue v. Leadership Housing, Inc.</u>, supra, at 615. Both statutes and state constitutional provisions are

subject to change, the only difference being that the latter change more slowly and with more labor. A taxpayer must be presumed to be aware that removal of the exemption in the future is entirely possible. No justifiable reliance on such an exemption can be claimed.

Appellants launch into a discussion of federal estate and gift tax cases ostensibly for the theory that a taxpayer must be "forewarned." The case of Untermyer v. Anderson, 276 U.S. 440, 48 S.Ct. 353 (1928), involved attempts to tax transactions completed prior to the effective date of the relevant statute. The case is not on point here because the Florida Code makes no attempt to tax past transactions.

As for City National Bank of Clinton v. Iowa State Tax Com'n.,

102 N.W.2d 381 (Iowa 1960), the court there supports the position of Appellees.

The case of Milliken v. United States, 283 U.S. 15, 51 S.Ct. 324 (1931), allowed taxation of a completed gift which the donor made in 1916. When the donor died in 1920, the court upheld taxation of the gift (in contemplation of death) under the rates authorized by the Act of 1918 (at rates slightly higher than those of the 1916 Act). This case is no authority whatsoever for the Appellants but, to the contrary, stands simply for the proposition that a tax may legally be imposed on a transaction taking place after the effective date of the statute. The Florida Income Tax Code, as noted, taxes only transactions occurring after January 1, 1972, the effective date of the statute, when each taxpayer

of the State of Florida is charged with knowledge that transactions of the sort involved here will be liable for the tax.

Appellees would have this Court accept the proposition that the Florida Code somehow retroactively taxes the voluntary act of refraining from selling property prior to the taxing statute in reliance on the lack of taxing authority. This contention is eminently unsound and constitutes an attempt to twist the principles of taxation. Appellees were sufficiently forewarned, by the passage of the Florida Code, that future transactions, and only future transactions would be taxed. The notion that the "act of not acting" is in itself a past transaction which may not be retroactively taxed is absolutely without any statutory or case substantiation.

Finally, with respect to this point, it must be observed that this Court has upheld the imposition of federal taxes on capital gains accruing prior to the date of the Sixteenth Amendment against a claim of unconstitutionality. Lynch v. Hornsby, 247 U.S. 339, 38 S.Ct. 543, 62 L.Ed. 1149 (1917). In that case, the federal government sought to tax dividends resulting from surplus assets accumulated from 1906, when purchased by the plaintiff, until 1915, when realized as income by the plaintiff. The Court, finding that the March 1, 1913, limitation of the Internal Revenue Code did not apply to this type of situation, permitted taxation of those dividends when realized, even though they were based on surplus accrued prior to not only the date of the statute but also prior to the Sixteenth Amendment, so long

as the income was realized after the adoption of the amendment. In reading the case, it is important to keep in mind that the Internal Revenue Act went into effect at substantially the same time as the Sixteenth Amendment and therefore accumulations prior to the act were also prior to the amendment. It is submitted that Lynch v. Hornsby, supra, is so closely analogous to the facts at bar as to be indistinguishable.

Appellants second contention amounts to an attack directly on the decision below as itself violative of due process. Appellants argue that they were deceived, that the decision appealed from retroactively changed the definition of income and rendered taxable what had always been understood to be nontaxable.

It has been pointed out before, and it must be repeated here, that the decision below in this case is in no way inconsistent with prior Florida decisions dealing with the meaning of income. Appellants can point to no authority which directly holds, or from which it may reasonably be inferred, that the word "income" in the Prohibition included unrealized capital appreciation. Indeed, as demonstrated above, the decisions of State v. Keller, supra, Owens v. Fosdick, supra, and Mahan v. Lummus, supra, while having no occasion to explicitly define income, treated the concept in a manner entirely consistent with the definition given to that term by the decision below. Without such authority, Appellants contention is frivilous. There is simply no authority upon which they can ground

their protestations of "justifiable reliance." If the Appellants were justified in relying on anything at all, it would have been in relying upon the commonly accepted definition of income with respect to capital gains, as used in virtually every federal and state case on the issue throughout the period when the Prohibition was in effect. That definition does not consider capital gain as income until realized.

This Court has recently dismissed an appeal and denied certiorari in a case seeking to challenge a state court decision as arbitrarily altering the law of the state. Esteva v. Boardman, 323 So.2d 259 (Fla. 1975) app. dism. & cert. den. 48 L.Ed.2d 791, 96 S.Ct. 2162 (1976). It is submitted that the instant appeal warrants the same disposition.

CONCLUSION

Wherefore, Appellee respectfully submits that this Court does not have jurisdiction to entertain either an appeal or certiorari in this matter and further that the question presented by this appeal is so unsubstantial as to warrant no further argument. Appellee respectfully moves the Court to dismiss the appeal or, in the alternative, to affirm the judgment entered in the cause by the Supreme Court of Florida.

Respectfully submitted,

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